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COMMENT AND OPINION

The Depreciation Regulations A Protest

WE reproduce on another page a copy of a letter from the Committee on Accounting and Auditing Research to the Minister of Finance which expresses most cogently some of the strong and, we may add, widespread objections to the new income tax regulation that companies can only claim depreciation to the extent that it has been included in their financial statements. There are a few thoughts of our own which we would like to add.

Depreciation of plant and equipment is, in our view, one of the elements in the cost of production, which of necessity enters into the computation of the profit or loss. Prior to 1949 depreciation was so regarded also for tax purposes: plant and equipment, it was agreed, depreciated from user in the productive process, and the loss of value was accordingly an expense of operation. From this it followed that the allowance was conditional on user of the plant or equipment in production and that depreciation occurred regardless of whether or not a profit was made. Some relaxation was allowed from the strictness of this last requirement, but the concession rather emphasized than impugned the validity of the viewpoint described.

However, in the actual administration of the Act, the Minister, who then had absolute discretion as to the granting of depreciation allowances, laid it down as a condition that depreciation would only be granted to the extent that it was recorded in the taxpayer's books of record and on his financial statements, the reason presumably being administrative convenience. While objections to that requirement were heard from time to time, it was, we believe, the general view that it did no great harm. This general acquiescence in the requirement resulted from the fact that the accounting and Revenue views of depreciation were, in the main, in harmony both as to the rate of depreciation and the method of applying the rate, namely on the straight-line basis, i.e. by the deduction of the same amount yearly (modified in years of loss) during the estimated life of the asset.

But now a revolution has taken place in the taxation treatment of what used to be called depreciation. Indeed it is no longer, either in name or in fact, depreciation at all. Rather it is now become an allowance in respect of capital cost. No longer is it an allowance for loss of value of plant and equipment used in the productive process; it is instead a recoupment of the capital cost of property acquired for the purpose of earning income. In that respect it departs from the accounting concept of depreciation. It also departs from generally accepted accounting practice in that the amount which may

annually be recouped progressively diminishes, and although the taxpayer is not bound to claim anything, neither can he claim an amount in excess of the maximum allowed by regulation, which grows less year by year. The new allowance for capital cost may thus in many cases have only the vaguest relationship to depreciation allowances as conceived by the accountant.

Be it clearly understood that no complaint is directed at the distinction now made between the allowances for capital cost permitted for taxation purposes, which are designed to enable the taxpayer to recover his capital costs free of tax, and depreciation allowances properly so-called, namely, the estimated loss in value of the same capital assets in consequence of their user in the productive process. It is submitted, however, that we are here dealing with two entirely different things, that the one is of no less importance than the other, and that it is retrograde and unwise to endeavour, as Reg. 1100(4) does, to force the accounting of profit and loss to be based upon false factors, which is presumably done for no other purpose than the greater convenience of administration.

As it appears to us, the requirement that allowances for capital cost cannot exceed the amount deducted on a company's financial statements is a revival of the former discretionary requirement to the like effect. As we have said, this did no great harm under the old scheme of depreciation allowances when the tax and accounting viewpoints substantially coincided. But with the change that has taken place this requirement will cause continuing and, we believe, ever mounting dissatisfaction. We join with the Committee on Accounting and Auditing Research in urging its revocation.

International Congress on Accounting Postponed to 1952

THE Sixth International Congress on Accounting will not be held in London in the summer of 1951 as originally planned but in the following year instead. The sponsoring bodies in Britain have issued an announcement to this effect, which states that the difficulties of ensuring suitable accommodation during the period of the Festival of Britain have proved insuperable, and that they have been reluctantly obliged to postpone the Congress until the following year.

Executive Committee Mid-Year Meeting

THE Executive Committee of the Dominion Association of Chartered Accountants met in Toronto on January 10 and 11, 1950. All members of the Committee were present except Mr. J. R. Church who was unable to attend because of illness. Mr. R. F. Bruce Taylor, chairman of the Editorial Committee, and Mr. P. F. Seymour, chairman of the Committee on Education and Examinations, also attended the meeting on the invitation of the Executive Committee.

In addition to discussing problems arising from reports of committee chairmen, the Executive reviewed the replies from the Institutes on proposals to amend the Association's by-laws. These proposals had been discussed by Council at its meeting in September and referred to the Institutes for an expression of opinion.

The 1950 annual meeting will be held in Charlottetown, P.E.I., August 21 to 25 inclusive. The Prince Edward Island Institute gives assurance that a visit to the Island will prove both profitable and enjoyable.

TIME-TABLE OF SPRING 1950 FINAL UNIFORM EXAMINATION

The Board of Examiners-in-Chief announce that the 1950 spring final examination of The Institutes of Chartered Accountants in Canada will be held on Thursday, Friday and Saturday, May 25, 26 and 27 and Monday, Tuesday and Wednesday, May 29, 30 and 31, according to the following time-table:

Thursday, May 25	FINAL AUDITING I
Friday, May 26	FINAL AUDITING II
Saturday, May 27	FINAL ACCOUNTING I
Monday, May 29	FINAL ACCOUNTING II
Tuesday, May 30	FINAL ACCOUNTING III
Wednesday, May 31	FINAL ACCOUNTING IV

The sessions will be from 9 a.m. to 1 p.m.

Current Reading

As Others See Us

LEST we have too high a regard for ourselves, we should take warning from the following paragraph in the annual report of the chairman of Anglo-Scottish Amalgamated Corp. Ltd. quoted in *The Economist,* December 17, 1949,

VALUE OF CORPORATION'S STOCK

If you will turn to the consolidated balance sheet you will find that the valuation of our investments shows a depreciation of £40,000, but this, gentlemen, is amply covered by the reserves on the other side of £359,000. In the old days before the bringing into effect of the new *Companies Act* it was a comparatively simple matter for a shareholder to find out exactly what the value of his stock was. Today, with the complicated balance sheets we have to produce, which as far as I am aware, are only understood by accountants, the shareholders, unless they are accountants, cannot find out the value of their stocks. Luckily, in this company we have an accountant in the office, and we have been able to work out the value of your stock, which equals 209 per cent.

We have noticed a number of criticisms of published accounts prepared under the new *Companies Act* in the United Kingdom. All complain of the profuseness and complexity of the items shown. This supports the argument of many in Canada that statements produced under the provisions of our *Companies Act* (Canada) with due consideration being given to our own Statement of Minimum Disclosure (. . etc.) permit a flexibility not possible if detailed legislation must be adhered to.

Press Relations Again

REVERTING to our comment under the heading "Press Relations" in our November issue, we were amused to read the following quotation from the address of the president, The Institute of Chartered Accountants in England and Wales, on the occasion of the 75th anniversary of the founding of *The Accountant*, November 2, 1949,—

PURPOSES AND OBJECTS
OF THE EMBRYO PROFESSION

With truly remarkable prescience, *The Accountant* set out in its first issue what it conceived to be the purposes and objects

of the embryo profession in order, it was stated, to raise the standing and promote the interests of accountants and thereby benefit the public at large. It urged the necessity for qualifying examinations and the establishment of libraries and expressed the view that:

"To effect these and other beneficial objects and to give *bona fide* public accountants that status to which they are entitled by virtue of their responsibility and skill, it would be well for all the respectable members of the profession to bind themselves together and, avoiding small matters of difference, work with a will to obtain the ultimate formation of an acknowledged profession."

The reference to "respectable accountants" may possibly have been prompted by the first letter in the correspondence column which might equally well have been written today. The writer drew attention to the not infrequent reports in the police intelligence of the daily papers of some swindling cases in which the person accused was described as an accountant. He concluded his letter with the following appeal:

"I think, sir, you would be doing the body of *bona fide* accountants an immeasurable benefit if you could, through your columns, call the attention of our magistracy to the 'described as accountant' nuisance, and prevail upon them to deal in the strictest manner with the dishonest rogues who, when the rascality is brought to light, adopt a description to which they have no title simply for the purpose of leading 'his worship' and the public to believe them respectable men of business."

Help On a Dull Subject

WE HAVE greatly enjoyed the following book review reproduced in whole from *The Economist,* November 19, 1949. The sentence "But the technique of guiding amateurs over the ground is a difficult one for professional instructors to acquire", intrigues us. Would one ordinarily find an amateur instructor better than a professional instructor — or is someone who has to deal with financial and investment problems in his everyday business entitled to call himself an amateur?

Elementary Theory of Finance, by William Lundie; John Smith and Son; pp. 133; 8s. 6d.

This book is written by the Lecturer in Mathematics and Actuarial Science at the Glasgow Institute of Accountants and Actuaries and is primarily intended for students preparing for the "intermediate" — a euphemism for the most elementary — examination taken by would-be chartered accountants in Scotland. The author indicates in his introduction, however, that he has cast his net rather wider than is usual in such works in the hope of interesting those who have to deal with financial and investment problems in their everyday business.

In the event Mr. Lundie has written something which is too competent as a textbook for it to fulfil any other useful purpose. Actuaries, accountants and, to some extent, bankers, are fated by their profession to carry the cross of that rather dull sort of factual examination, which most people leave behind at school, into realms of quite incredible, technical complexity. There is no doubt that many ordinary business men would do well to acquaint themselves with the ground covered by these professional examinees in the earlier stages of their journey. But the technique of guiding amateurs over the ground is a difficult one for professional instructors to acquire. Examinees need books such as this, which seeks to impress rigid formulae on their minds (without always quite fully explaining them), which underlines the pitfalls dear to the hearts of examiners (but to nobody else) and which sets out — in 133 pages of text — no less than 134 mathematical exercises. But the wider audience, which Mr. Lundie apparently seeks, is likely to wilt under such schoolmasterly handling.

To the Minister of Finance

The Committee on Accounting and Auditing Research protest the limitation of the capital cost allowance to the amount shown on a company's financial statement

Toronto, February 9, 1950

Hon. D. C. Abbott, K.C., M.P.,
Minister of Finance,
Ottawa, Canada.

Dear Mr. Abbott:

The Accounting and Auditing Research Committee of The Dominion Association of Chartered Accountants has been studying the new depreciation regulations which were published in *The Canada Gazette* of December 22, 1949. This Committee is concerned solely with the accounting implications of these regulations and not as to whether they result in a satisfactory method of determining taxable income. We have come to the conclusion that there are very serious accounting consequences arising from s. 1100(4), consequences which are not obvious on first reading and which may not have been foreseen or intended at the time the regulations were framed. This subsection reads as follows:

> Where the taxpayer is a corporation, the aggregate of the allowances under subsection (1) or (2) shall not exceed the amount deducted in respect of such allowances in computing the income or profit for the taxation year shown on the financial statements presented to the shareholders or members.

This subsection appears merely to limit the amount of depreciation claimed by corporations for tax purposes in any year to the amount shown as a deduction in determining income of that year on the financial statements. At first sight this appears to go little further than the previous limitation of depreciation to the amount recorded in the books of account, but the change to a diminishing balance method, the provision for recapture under certain circumstances and the allowance for obsolescence inherent in *The Income Tax Act* and the new regulations produce new complications. In effect, s. 1100(4) forces taxpayers to keep their fixed asset accounting in line with Part XI of the income tax regulations, or suffer a serious tax disadvantage.

Most companies have in the past followed a straight line method of depreciation. If they continue to write depreciation on this basis in 1949 and subsequent years and it is less than the amount permitted by the regulations, the effect of s. 1100(4) will be that in later years the company will not be permitted to write off the full amount of its asset unless and until it disposes of the entire group of which this asset forms a part. On the schedule on p. 54 is shown the disallowances which arise to a company writing off depreciation on machinery and equipment at 10% on a straight line basis. You will note that at the end of the tenth year the company has already suffered tax disallowances of 5½% as against what it would have been allowed had the diminishing balance method been followed in its accounts. In addition, if the company had adopted the diminishing balance method it would have been able to claim almost 90% of the remaining balance over the next 10 years.

This may be summarized as follows:

	Depreciation written by company on straight line basis	Depreciation allowed by regulation	
		If company adopts departmental rates in its accounts	*If company writes on straight line basis*
1st 10 years	100%	89.263%	83.616%
2nd 10 years	—	9.584	—
	100%	98.847%	83.616%

In any case a company which writes *more* depreciation than that allowed by the Tax Department, irrespective of whether it adopts the diminishing balance method or not, will be unable to claim the full amount of depreciation over the life of its assets as the larger amount written in the earlier years cannot again be written through the company's accounts. Based on our studies and on discussions with various taxpayers, we are forced to the conclusion that if s. 1100(4) continues in its present form, most tax paying companies will have no practical alternative but to adopt the Departmental procedures. In the case of regulated companies, such as public utilities, where the depreciation is seldom if ever determined on a diminishing basis, and in the case of subsidiaries of United States companies where the depreciation provision must be consistent with that of the United States parent company, the effect of the regulations will probably be to deny to these companies part of the depreciation on their fixed assets.

The application of this subsection will have certain unfortunate effects:

(1) The amount of depreciation claimed for the year will in some cases be more and in others less than that which would otherwise be regarded as proper in the considered judgment of the management. In those cases where the management and directors have freedom of choice as to the establishment of a depreciation policy, it is inevitable that they will adopt in their accounts the Department's basis of depreciation in order to obtain a full allowance for depreciation over the lives of the assets. This will require that some expenditures which have been written off by the company, but which were not allowed for tax purposes as being chargeable against the operations of one year, will have to be restored in the accounts. It would also result, and this is more serious, in the adoption of the diminishing balance method of depreciation in cases where such a method is inappropriate for accounting purposes. We recognize that the diminishing balance method of depreciation is considered by accountants as being an acceptable method of determining depreciation in some cases, and it may be that it might be used with advantage by many companies who have previously used the straight line method of depreciation. On the other hand, there are cases where the method is definitely inappropriate for accounting purposes and we do not think that such companies should be forced to adopt it or else be unable to claim for tax purposes the full amount of depreciation in respect of the capital cost of their assets.

(2) If taxpayers are in effect forced to adopt the Departmental method of determining depreciation in order to avoid a heavy tax penalty, it will require

companies to carry forward in their fixed asset accounts balances which good accounting practice would require should be written off to profit and loss or surplus as being in the nature of capital losses. An obvious example would be the case of a company with two buildings costing $100,000 each and on which no depreciation had been written. If one was destroyed by fire and there was no insurance, good accounting would require that $100,000 be written off at that time. On the other hand, in order to obtain the maximum depreciation allowance under the regulations, it would be essential that the $200,000 balance be continued in the company's accounts so that depreciation on this amount could be claimed over a period of years.

(3) While it might be argued that the company's financial statements would be misleading if depreciation were written in amounts very substantially less than that claimed for tax purposes, we submit that this is not so serious as at first glance appears, as the statements must reflect depreciation on a proper accounting basis if the auditors are to give an unqualified opinion. On the other hand, we also submit that a taxing statute should not be used to police the reporting by the directors of the company to its shareholders.

While we consider that these unfortunate consequences are such that s. 1100 (4) should be repealed at once, we have attempted to visualize the problem of the Department. We recognize that if the taxpayer's accounts were brought in line with the Departmental records of depreciation it would reduce the work of the Tax Department somewhat. The present regulations, however, do not achieve this result. Corporations must still keep separate accounts for assets and reserves for depreciation in order to conform with the requirements of the *Companies Act* and accepted accounting practice. Existing differences between Departmental and company records are many and these will still continue to exist; for example, depreciation claimed prior to 1933 which was not written in the accounts of the company and depreciation written in excess of that allowed by the taxing authorities. So far as future years are concerned, further differences will appear in that, even if a taxpayer adopts the diminishing balance method, it may still take capital gains in its accounts through surplus, which the Tax Department will consider as being a recapture of depreciation, and therefore be credited against the depreciated cost of the group.

We strongly recommend that s. 1100 (4) be repealed. As at this time of the year many companies are preparing their annual financial statements, you will recognize the advantage to business generally in the Government's prompt consideration of this matter and an early decision.

Yours sincerely,
J. R. M. Wilson,
Chairman, Accounting and Auditing Research Committee

(For a table showing comparison of depreciation written on straight line and diminishing balance basis see page 54)

COMPARISON OF DEPRECIATION WRITTEN ON STRAIGHT LINE AND DIMINISHING BALANCE BASIS

	10% Written off on a Straight Line Basis	20% Written on Reducing Balance Basis		Allowable for Tax Purposes If Straight Line Basis is Used in the Accounts	
Year	*Annual Provision*	*Annual Provision*	*Undepreciated Balance*	*Annual Amount Allowable*	*Disallowance*
1	10%	20 %	80 %	10 %	—
2	10	16	64	10	—
3	10	12.8	51.20	10	—
4	10	10.24	40.96	10	—
5	10	8.192	32.768	10	—
6	10	6.554	26.214	10	—
7	10	5.243	20.971	8	2 %
8	10	4.194	16.777	6.4	3.6
9	10	3.356	13.421	5.12	4.88
10	10	2.684	10.737	4.096	5.904
11		2.447	8.590	—	—
12		1.718	6.872	—	—
13		1.374	5.498	—	—
14		1.100	4.398	—	—
15		.880	3.518	—	—
16		.704	2.814	—	—
17		.563	2.251	—	—
18		.450	1.801	—	—
19		.360	1.441	—	—
20		.288	1.153	—	—
	100%	98.847%	1.153%	83.616%	16.384%

La Banque au Canada

Par Louis-J. Trottier, C.A., F.C.I.S.
(Gérant Général Adjoint à la Banque Provinciale du Canada)

Evolution et expansion du système bancaire canadien

LE système bancaire canadien est le résultat de plus d'un siècle d'évolution. Je crois qu'on peut fixer sa date de naissance à la fondation de la Banque de Montréal qui a eu lieu, comme on le sait, en 1817. La Banque de Montréal est la plus vieille banque du Canada. Avant sa fondation, il n'existait chez nous aucune organisation bancaire proprement dite. Plusieurs des fonctions essentielles de la banque étaient assurées par des marchands, lesquels allaient jusqu'à émettre leur propre monnaie. La plupart des banques qui furent établies dans la suite dans le Bas et le Haut Canada copièrent la charte octroyée en 1822 à la Banque de Montréal. Finalement, la première loi canadienne de la Banque, votée par le Parlement en 1871, sanctionna les principes généraux des chartes provinciales des diverses banques parmi lesquelles dominaient celles du Bas et du Haut Canada.

L'Origine de Nos Banques

Nous pouvons faire remonter encore plus haut l'origine de nos banques. Bien qu'elles diffèrent aujourd'hui des banques américaines sur des points essentiels, elles comptent néanmoins parmi leurs ancêtres la première banque des Etats-Unis. La constitution de la Banque de Montréal reproduisait, en effet, les principales clauses et même la phraséologie de la charte de celle-ci. De même, les chartes des banques des provinces maritimes s'inspiraient des lois bancaires de la Nouvelle-Angleterre. Nos banques tirent également leur origine de la Grande-Bretagne. La constitution de la première banque des Etats-Unis s'inspiraient des règlements des banques anglaises et écossaises que son auteur, Alexander Hamilton, connaissait à fond.

Le système bancaire canadien s'est adapté graduellement aux besoins particuliers du pays. Lors de la fondation de la Banque de Montréal, le pays était divisé en colonies relevant chacune directement de l'Angleterre. Les communications étaient difficiles, et les besoins du commerce et de l'industrie limités. Nos premières banques furent des institutions locales ou, tout au plus, régionales. Elles étaient régies par des lois provinciales. Il n'y avait donc aucune législation uniforme. Nous n'avions pas encore une loi nationale de la banque.

Causerie devant The Chartered Accountants Students Society de Quebec, Montréal, 20 octobre 1949

La Confédération fit disparaître les systèmes monétaires provinciaux. Le gouvernement fédéral racheta les émissions provinciales et les remplaça par des billets du Dominion. De même, les banques tombèrent sous sa juridiction, et, en 1871, nous eûmes une loi canadienne de la banque. Nos banques furent, dès lors, des institutions nationales. Elles purent répondre aux besoins agrandis du commerce qui, par suite de l'amélioration des moyens et des voies de communication, débordaient les cadres régionaux et tendaient à prendre des proportions nationales. Le système bancaire canadien date donc de 1871. Avant, nous avions bien des banques, mais nous n'avions pas de système bancaire uniforme.

Revisions Décennales

Après la Confédération, cette adaptation aux besoins du pays continua, mais, cette fois, sous la surveillance étroite de l'Etat. Les conditions sociales et économiques d'un pays progressif changent et se développent, et il faut adapter à ses transformations son système bancaire qui forme une partie essentielle de son armature économique. C'est pour cette raison que le Parlement canadien à une de ses premières sessions décréta que notre législation bancaire serait revisée à tous les dix ans. Conformément à cette disposition toujours en vigeur de la loi de la Banque de 1871, il y a eu jusqu'ici sept revisions décennales, en 1880, 90, 1900, 1913, 23, 34 et 1944. Les modifications apportées à chaque revision nous ont donné notre loi actuelle de la banque et notre système bancaire d'aujourd'hui.

Voici quelques unes de ces modifications. Je les choisis parmi celles qui n'ont pas perdu toute leur actualité. La première revision déclara les billets des banques à charte — il y en a encore en circulation — titres de premier privilège contre l'actif général des banques. Le nom de banque fut réservé strictement aux banques à charte. En 1890, on créa le fonds de rachat de la monnaie fiduciaire, afin de prémunir les détenteurs de billets de banque contre toute perte dans l'éventualité d'une faillite. On permit aux étrangers de devenir membres des conseils d'administration, à la condition que la majorité des administrateurs soient sujets britanniques. En 1900, le Parlement accorda sa reconnaissance officielle à l'Association des Banquiers Canadiens, fondée en 1899. Cette association contribua et contribue encore très efficacement à développer la collaboration entre les banques. En 1923, on modifia l'article 88 de façon à exiger l'enregistrement des garanties des emprunts. A la suite de la faillite de la Home Bank, survenue en 1923, l'inspection gouvernementale fut établie. Enfin, en 1934, la Banque du Canada fut constituée à la recommendation d'une commission royale d'enquête sur la banque et le système monétaire. Le privilège d'émettre des billets de banque fut réservé à la Banque du Canada et les banques à charte furent obligés de racheter leurs billets en circulation.

Traits Distinctifs

Les causes qui ont influé sur l'évolution de la banque dans notre pays sont d'ordre politique, géographique et économique. Les causes politiques sont, d'abord, la conquête, qui a fait que notre système bancaire soit d'inspiration britannique, au lieu de française; la proximité des Etats-Unis, qui nous a fourni l'occasion de nombreux emprunts au système américain; l'organisation du pays en colonies autonomes, ce qui a eu pour conséquence le caractère provincial de nos premières banques; et enfin, le régime fédératif, à qui nous devons de posséder un système bancaire national.

Un trait distinctif du système bancaire canadien est la multiplicité des succursales. Cette caractéristique est due en bonne partie aux conditions géographiques de notre immense pays. Le Canada se compose de quatre grandes régions, ayant des intérêts économiques particuliers: les quatre provinces de l'Atlantique, le Québec et l'Ontario, la Prairie et la côte du Pacifique. Cette diversité régionale a produit un effet marqué sur le système bancaire canadien, influant sur le développement des succursales. On y trouvait le moyen de concilier tant d'intérêts divers et de répondre aux exigences saisonnières variées d'industries très dispersées. Par exemple, une banque à Montréal peut répondre aux besoins des commerçants de Vancouver grâce aux succursales qu'elle possède dans cette ville. Par ailleurs, d'une façon générale, l'épargne est peu abondante dans les provinces de la Prairie et la demande de crédit, très forte. Grâce à son réseau de succursales, le système bancaire canadien peut satisfaire aux besoins de crédit dans les provinces de l'Ouest en utilisant à cette fin le surplus d'épargne du Centre et de l'Est. De la même façon, il peut répondre aux besoins saisonniers de toutes les parties du pays.

Expansion et Evolution

L'article 4 de la loi de la banque de 1871, article inspiré du système écossais, a rendu possible la multiplication des succursales et agences. Il autorise les banques à ouvrir des bureaux "en toute localité de la Puissance". Les lois américaines, au contraire, interdisent aux banques de rayonner par le moyen de succursales en dehors du cadre restreint de l'Etat ou même de la cité.

Le système bancaire canadien a grandi avec le Canada. En faisant l'historique, on peut retracer toutes les étapes du développement économique du pays. A chaque progrès du commerce ou de l'industrie, correspond une nouvelle expansion de la banque. Au cours de la période de prospérité qui marqua les débuts de la Confédération, l'actif total des banques passa de $85 millions en 1868 à $200 millons en 1874. La dépression financière et commerciale qui suivit se traduisit par une chute brusque de cet actif à $167 millions en 1875. La période de 1880 à 1890, au cours de laquelle fut parachévée la ligne transcontinentale du Pacifique Canadien, fut pour le Canada une période d'expansion dont nos banques profitèrent. Leur actif passa de $192 millions à $260 millions. De même, au cours des années d'abondance du début du siècle, l'avoir des banques de $501 millions en 1900 monta à $1,001 millions en 1908.

A compter de 1900, nos banques entrèrent dans une période de consolidation du point de vue de l'organisation générale du système. Bien que le nombre des succursales continua à se multiplier, celui des banques ne fit que diminuer. En 1900, on comptait 36 banques à charte. En 1918, il n'en restait plus que 18. En 1931, seules subsistaient les dix banques actuelles.

M. Louis-J. Trottier, C.A., F.C.I.S., docteur en sciences commerciales, est gérant général adjoint à la Banque Provinciale du Canada depuis 1946. Il a fait ses études à l'école des Hautes Etudes Commerciales oú il obtint la licence en sciences commerciales. En 1948, on lui décernait un doctorat en sciences commerciales (honoris causa).

M. Trottier a été, notamment, trésorier du Trust Général du Canada, de 1927 à 1942 et président de la commission d'assurance chômage, de 1942 à 1946.

La plus récente étape de l'évolution incessante du système bancaire canadien a été la fondation en 1934 de la Banque du Canada, qui en est comme le couronnement.

Il est intéressant de signaler ici qu'en 1933 deux éminents banquiers canadiens (M. Beaudry-Leman et Sir Thomas White) ont fondé leur opposition à l'établissement alors d'une banque centrale sur la crainte que la mesure ne crée de la perturbation dans notre système monétaire et n'interrompe l'évolution normale de notre système bancaire.

Solidité de Notre Système

Notre système bancaire, sans doute, reste toujours perfectible. Il subira encore des modifications pour répondre à des besoins nouveaux créés par la transformation incessante des conditions économiques. Cependant, dans sa forme actuelle, dans sa souplesse et sa facilité d'adaptation, il mérite qu'on en soit fier. Il est maintenant d'une solidité qui semble pouvoir subir de très forts bouleversements. Qu'on se rappelle, il a traversé sans une seule défaillance la terrible crise économique précipitée par la panique boursière de 1929. Il n'en a malheureusement pas été de même aux Etats-Unis, qui sont un des rares pays n'ayant pas de système national à succursales. La crise a été fatale à un grand nombre de banques américaines. Au cours de la période allant de 1921 à 1931, environ 8700 d'entre elles, ayant pour 4 milliards de dépôts, ont été forcées de fermer. En 1932, 1,453 faillissaient; 4,000 en 1933. Au cours de ces années difficiles, de nombreuses critiques ont été formulées à l'adresse de notre système bancaire. Cela était inévitable. Cependant, en 1933, l'enquête de la commission royale chargée de préparer la revision de la loi de la Banque, a constaté que ces critiques ne justifiaient aucun changement radical dans le système bancaire, mais concernaient plutôt la routine des banques.

Exemple à Suivre

Le plus sûr moyen d'arriver à la perfection dans un domaine comme la banque, est une lente évolution. Il est, en effet, bien dangereux de tenter des expériences dans le domaine financier. Il n'existe pas de laboratoire où l'on puisse sans crainte faire l'essai des théories nouvelles. Il faut expérimenter sur la réalité, risquant à tout instant de compromettre la fortune des êtres humains, et leurs conditions de vie. L'échec de l'expérience serait de nature à produire des consequences désastreuses. La façon sage, lente et progressive dont s'est bâtie peu à peu la banque au Canada, s'adaptant graduellement aux besoins nouveaux et se perfectionnant sans cesse, pourrait aujourd'hui servir d'exemple à d'autres institutions similaires, et, sur le plan politique, aux hommes publics de plus d'un pays. Nous vivons une époque troublée de luttes violentes entre les classes de la société, une époque d'expériences audacieuses dans le domaine économique. Le système bancaire canadien enseigne dans son évolution à tous ceux qui ont entre leurs mains la responsabilité du bien-être des peuples, la prudence avec laquelle il convient d'effectuer toute modification tant soit peu radicale dans les structures économiques, sociales ou politiques d'une nation.

Nous avons parlé jusqu'ici de la formation graduelle du système bancaire canadien. Il convient maintenant pour compléter le tableau de vous donner une idée de son ampleur actuelle.

3543 Succursales

Au moment de la Confédération, nous pouvions compter 147 succursales de banque du Canada. Il y en avait

déjà 708 en 1900. Aujourd'hui, nos banques à charte possèdent ensemble 3,543 bureaux, distribués dans toutes les régions habitées du pays.

Après l'Ecosse, le nôtre est le pays où il y a le plus de bureaux de banque par habitants — 1 par 3,900 habitants environ. Nos banques ont essaimé à l'étranger avec beaucoup de succès. Elles ont en dehors de nos frontières 105 succursales: 66 aux Antilles, 19 en Amérique du Sud, 11 aux Etats-Unis, 7 en Grande-Bretagne et 2 en France.

Quatre de nos dix banques ont des succursales dans toutes les provinces: les banques de Montréal, Royale, de Nouvelle-Ecosse et de Commerce. Ce sont les "Quatre Grands" du système bancaire canadien. Elles détiennent à elles seules 75% de l'actif global du système avec moins de 60% des succursales. Sur les 105 succursales à l'ètranger, 92 leur appartiennent.

Quant aux banques canadiennes françaises, on trouve leurs 864 bureaux dans le Québec et les centres français de l'Est, sauf quelques succursales et agences dans l'Ouest, et dans les centres anglophones.

Coopératives de Crédit et Caisses d'Epargne

On ne peut parler de nos banques, sans au moins mentionner deux groupes d'institutions importantes qui ne font pas partie du système de nos banques commerciales. Ce sont nos coopératives de crédit et nos caisses d'épargne. Nos coopératives de crédit ont pris une grande expansion depuis 1940, surtout dans la province de Québec où elles sont connues sous le nom de Caisses populaires Desjardins, et ont un actif d'environ $180,000,000 Pour ce qui est de nos caisses d'économie, la Banque d'Epargne de la Cité et du District de Montréal et la Banque d'Economie de Québec, elles ont respectivement un actif de $155,000,000 et de $27,000,000.

En traitant le sujet des services de la banque, je n'ai pas l'intention de me contenter d'énumérer des opérations que vous connaissez bien. Je m'efforcerai plutôt de vous exposer les raisons fondamentales de la ligne de conduite adoptée par les banques dans la dispensation de leurs services. En d'autres termes, je tâcherai de donner une réponse satisfaisante à des questions que vous avez dû probablement vous poser: Pourquoi la banque ne paie-t-elle pas d'intérêt sur les dépôts courants? Pourquoi l'intérêt des dépôts d'épargne est-il si minime? Pourquoi la banque ne prête-t-elle pas à long terme? Pourquoi la banque manifeste-t-elle tant de prudence dans ses prêts?

Réserves Primaire et Secondaire

La banque reçoit des dépôts d'argent. C'est là sa fonction la plus connue. L'idée de dépôt est associée à celle de banque. Selon la conception populaire, la banque est le dépositaire à qui on peut confier son argent en toute sécurité.

En théorie, seuls les dépôts au compte courant, c'est-à-dire les dépôts ne portant pas intérêt, sont remboursables sur demande. Les dépôts d'épargne sont, légalement parlant, retirables seulement sur avis donné par le déposant. Dans la pratique, toutefois, tous les dépôts qu'ils soient d'épargne ou courants, sont remboursés sur demande.

Le remboursement des dépôts sur demande, ou, exceptionnellement, sur un très court avis, est un fait capital qui dicte à la banque dans bien des cas sa politique. La banque doit pouvoir faire face en tout temps, d'abord, aux retraits courants, et, éventuellement, aux retraits massifs de ses dépôts. Cela l'oblige à maintenir deux réserves: un fort actif en espèces pour payer les re-

traits ordinaires et un actif facilement réalisable très considérable, ou réserve secondaire, pour honorer tout retrait massif possible. Il s'ensuit que la majeure portion de l'actif de la banque se compose de valeurs de tout repos promptement réalisables.

Comme comptables, il vous intéresse de savoir en quoi consistent l'actif en espèces, réserve primaire, et l'actif facilement réalisable, réserve secondaire des banques. L'actif en espèces comprend: la monnaie divisionnaire, les billets de la Banque du Canada, les dépôts à la Banque du Canada, la monnaie des Etats-Unis et des autres pays, les billets des banques à charte non encore retirés de la circulation, les chèques sur d'autres banques, les soldes dus par les banques et les correspondants étrangers, les soldes dus par d'autres banques canadiennes.

L'actif facilement réalisable comprend d'abord cette réserve primaire. Il comprend de plus les obligations des gouvernements fédéral et provinciaux, obligations municipales, effets publics étrangers, valeurs ferroviaires, prêts à demande et à courte échéance (d'au plus 30 jours) consentis au Canada ou à l'étranger sur la garantie de valeurs mobilières.

L'actif en espèces des banques rapporte peu. Leur actif facilement réalisable, composé, comme nous venons de le mentionner, de valeurs de tout repos, généralement à court terme, donne de faibles intérêts en comparaison des autres genres de placements canadiens. Il s'ensuit que la banque se trouve dans l'impossibilité de payer sur ses dépôts d'épargne un intérêt élevé.

Patterson écrit à ce propos dans son Canadian Banking: "Le rapport entre les dépôts portant intérêt et le capital et le fonds de réserve de la moyenne des banques est si grand que même une légère augmentation du taux d'intérêt, ou du coût de l'administration des dépôts porterait considérablement atteinte au rendement du capital, à moins que la question de maintenir des réserves suffisantes soit mise de côté," — en d'autres termes, à moins de courir le risque très grave de compromettre la sécurité des dépôts.

Si, en pratique, me demanderez-vous, tous les dépôts sont remboursés sur demande, pourquoi la banque paie-t-elle un intérêt seulement sur les dèpôts d'épargne?

Dépôts d'Epargne

Les dépôts d'épargne appartiennent généralement à des particuliers. A cause de cela, et aussi à cause de leur nature et du très grand nombre de déposants, ils ont beaucoup de stabilité. Leur rotation est très lente, au contraire de celle des dépôts courants. On estime que la rapidité de rotation des dépôts courants est d'environ cinquante fois celle des dépôts d'épargne. En somme, cela revient à dire qu'il ne serait pas profitable pour la banque de payer un intérêt sur des dépôts aussi instables que les dépôts courants, d'autant plus que le bénéfice net qui lui reste après paiement des frais d'administration des dépôts et de l'intérêt sur les dépôts d'épargne est peu élevé.

La réserve en espèces, qui garantit le paiement des retraits journaliers, joue dans les opéations de prêts et de placements de la banque un rôle comparable à celui du réservoir d'alimentation d'une centrale électrique. Plus l'eau est abondante dans le réservoir plus on en fait passer dans les turbines. De même, l'augmentation de la réserve en espèces par rapport au passif des dépôts, permet à la banque d'augmenter ses prêts, ou ses placements, à défaut d'une demande suffisamment forte au crédit. La diminution de cette réserve produit l'effet contraire. Elle force la banque à restreindre ses crédits ou à réaliser

ses placements, afin de maintenir toujours le même rapport entre son passif de dépôts et la liquidité de ses actifs. C'est en agissant sur la réserve en espèces des banques que la Banque du Canada peut le plus facilement réglementer le crédit dans l'ensemble du pays. Du point de vue strictement monétaire, les banques ne se laisseront influencer dans leur politique de prêts et de placements, pourvu toutefois qu'il existe un champ propice pour le prêt d'argent ou l'achat de valeurs, que par la somme de la réserve en espèces qu'elles croient nécessaire de garder pour parer à toute éventualité à leur passif de dépôts.

Le souci de maintenir une forte liquidité afin de pouvoir en tout temps honorer tous les retraits quelles que soient leur nature et leur étendue, explique pourquoi la banque, au Canada du moins, ne fait pas de prêts à long terme. En prêtant à longue échéance, elle risquerait de geler une portion considérable de l'argent des déposants et de mettre en péril la position liquide que la prudence lui commande toujours de maintenir. La Banque dispense essentiellement des crédits mobiliers à court terme. Un principe fondamental régissant les opérations de banque est que les crédits doivent être octroyés en relation de la production et de la vente des biens de consommation, et que les emprunts doivent être remboursés au fur et à mesure que les produits, qui leur servent de gages, sont livrés à la consommation.

Deux Exigences Contraires

Le fait que l'argent prêté est celui de leurs déposants, influe considérablement sur la politique de prêts des banques. Celles-ci ne perdent jamais de vue que les sommes dont elles disposent, ne leur appartiennent pas. Si d'un côté la banque est continuellement obligée de prendre certains risques dans les crédits qu'elles fait à ses clients, le souci de sauvegarder l'argent de ses déposants la force, d'un autre côté, à la prudence et à la circonspection. Devant maintenir une très forte liquidité, le pourcentage de ses prêts courants par rapport à son actif total sera nécessairement peu élevé. La banque se trouve perpétuellement coincée entre deux exigences contraires: d'une part, la crainte d'exposer l'argent de ceux qui ont en elle une confiance absolue, et, d'autre part, le désir de répondre à toutes les demandes légitimes de crédit. Le point d'équilibre de ces deux forces opposées est probablement au niveau actuel autour duquel le pourcentage des prêts commerciaux par rapport à l'actif total fluctue étroitement. Quand on tient compte de tous ces facteurs divers, il faut admettre que c'est à tort que certains reprochent aux banques de manquer de libéralité dans la dispensation des crédits. On aurait tort également d'affirmer que la banque n'avance de crédit que dans les cas où l'élément risque est soit négligeable soit inexistant. Prendre des risques ne veut pas dire être imprudent ou téméraire. La banque ne craint pas de courir tous les risques qui sont de bons risques; mais comme elle prête un argent qui ne lui appartient pas, elle n'a pas le droit de commettre des imprudences.

En plus d'accepter des dépôts et de faire des prêts, les banques canadiennes financent le commerce extérieur. Par l'entremise de leurs succursales (ou de leurs correspondants) à l'étranger, elles s'efforcent toujours de favoriser le commerce canadien, et, par leurs succursales ou autrement, elles mettent sur pied et maintiennent à jour à la disposition des exportateurs canadiens, une vaste documentation de crédit. En temps normal, les banques concentrent entre leurs mains le marché du change. Chacune a son service de change ex-

térieur où viennent se rencontrer l'offre et la demande des devises étrangères.

Autres Services

Les banques gardent dans leurs voûtes les valeurs mobilières et les papiers importants d'une foule de gens. Elles font l'encaissement des chèques. Les dépôts sujets aux retraits par chèques constituent le plus important moyen d'échange au Canada. Le gros des affaires publiques, commerciales et financières du pays se fait au moyen de chèques tirés sur les comptes courants.

Les banques sont les teneurs de livres de tous leurs clients. Comme ceux-ci sont au nombre de plus de 7 millions (7,221,000 comptes de dépôt, sans mentionner 800,000 clients-emprunteurs), nous pouvons dire qu'elles sont les teneurs de livres de la population entière. Les écritures mensuelles faites par les employés de banque aux comptes des particuliers représentent un montant de 6,500 millions de dollars. Ces écritures sont l'enregistrement des paiements par chèque que les Canadiens se font les uns aux autres en règlement de travaux accomplis, de services rendus, de marchandises produites ou vendues. Elles témoignent de centaines de mille transactions petites ou grandes.

Notre système bancaire fait l'admiration de l'étranger. Il gagne, dirait-on, d'être vu de l'extérieur. Vu de l'intérieur, il n'est pas toujours estimé à sa juste valeur. Trop souvent nous nous permettons à son endroit des critiques injustifiées. Certains disent que le système bancaire canadien est le meilleur au monde. Sans aller jusqu'à souscrire moi-même aveuglément à cette opinion, je puis du moins affirmer que nous avons raison d'être fiers de nos banques.

Recent Books

The Table Talk of Samuel Marchbanks, by Robertson Davies; Clark, Irwin & Co., Toronto; pp. 248, price $2.75

This is the companion volume to "The Diary of Samuel Marchbanks", which was reviewed by us in our February 1948 issue. Here the author has set his purpose to give us conversation pieces under headings which trace the course of a good dinner and he frequently reminds us that he is talking to the lady on his right or his left. As he says in his preface, "Those who wish to spare themselves the pains of getting passages by heart may take the book to dinner with them, and read aloud from it frankly. Those who, for one reason or another, are never asked to dine out may create an agreeable illusion of society if they will read the book to themselves, as they regale themselves with soda biscuits and weak tea, sitting at a corner of their own kitchen tables". To this we add, that if your spouse or companion becomes riled when you chuckle audibly while reading, find something with which she can occupy her mind fully. To have two copies of the book would be no solution for obvious reasons. This is light reading recommended for recreational purposes. The chapter decorations by Clair Stewart are excellent.

Handbook of Cost Accounting Methods, by J. K. Lauer, C.P.A.; D. Van Nostrand Co. (Toronto)

In the review of this book published in the October 1949 issue of *The Canadian Chartered Accountant*, we regret that the price was stated as $10.50. The correct price is $16.50.

A Long Step Backwards: Diminishing Balance Depreciation

By Kenneth F. Byrd, M.A., B.Sc. (Econ.), A.C.A.
(Professor of Accountancy, McGill University)

An argument against the method of depreciation recently adopted for income tax purposes

FOR many decades North America has been recognized as the home of the straight-line method of depreciation, and Britain, just as definitely, has been regarded as favouring the reducing instalment or diminishing balance method. Here, as in so many other fields of accounting practice, the division between the two countries has been clearly marked. It does not seem, however, to have been equally clearly noted that, five years ago, Britain came to the conclusion that her long clinging to the diminishing balance method was ill-advised and definitely harmful to the interests of good accounting. The Institute of Chartered Accountants in England and Wales published on January 12, 1945, the ninth[1] of its "Recommendations on Accounting Principles", dealing with the subject of depreciation. The recommendations included the statement that the straight-line method "is used almost universally in the United States of America and Canada and to a large extent in this country. Though other methods may be appropriate in the case of some classes of assets, *the balance of informed opinion now favours the straight-line method* as being the most suitable for general application". As regards the reducing balance method, "also largely used in this country", it warns that the percentage applied needs to be from two to three times that applied under the straight-line method. This is a fact not generally realised, the consequence being that rates of depreciation fixed on this basis may tend to be inadequate. In its final recommendation to its members the British Institute made no mention of the reducing balance method, but for buildings, plant, tools and equipment, ships, etc. it supported the use of the straight-line method, except where a particularly short life suggests other methods such as re-valuation.

Canada Lapses

At last, therefore, it might be said that Britain and North America were of the same mind in regard to an important accounting method. Britain had come over to America's point of view. How definitely this was so may be seen in the following extract from a brilliant editorial on the subject, which appeared at that time in *The Accountant*,

> The outstanding point that will at once catch the attention of every reader is that the time-honoured reducing bal-

[1] "Recommendations on Accounting Principles": (Gee & Co.).

ance system is now so thoroughly deposed from its former popularity that it is not admitted even to be a second-rate alternative; it disappears from the scene, unwept, unhonoured and unsung. A long time has elapsed since an authority attracted the criticism of the incredulous by remarking that the plan had "not one redeeming feature", but it seems that the big battalions have now come over to his side although, at this time of day, their trumpets have less need to be equally sonorous. Reflection must convince us all, we believe, that the only real recommendation of the plan always was the very weak one that it was easy to operate. It was, in fact, the lazy accountant's friend. Combined with the Englishman's mysterious reverence for 5 per cent., it was a positive danger. In retrospect the classical argument that falling depreciation, combined with rising maintenance costs, effected a rough equality seems amazingly weak. The connection between depreciation, regarded as a foreseeable mathematical factor, and maintenance, which after all must often be sporadic and accidental, never was logically clear; and, in any event, the task of setting up an equalisation fund to deal with repairs never has been beyond the competence of accountants. We glance, but we are afraid with only ill-concealed contempt, at the alleged argument that the practice of the Inland Revenue in the matter of wear and tear affords reliable argument. Even the walls of the citadel at Somerset House show signs of crumbling and it is high time that accountancy science should lead the Inland Revenue rather than follow as an obedient lamb to the slaughter.

Scarcely, however, has this happy unanimity become a fact, outstanding among the other accounting principles and practices about which the two countries still disagree, when Canada decides that, for *income tax purposes,* the diminishing balance method is not such a bad idea after all. Her Minister of Finance, seeking ways of taking into account for income tax calculation the losses through obsolescence which have not hitherto been allowed, sees in the diminishing balance method a means of allowing higher charges against profits in the earlier years of an asset's life. The nation is, therefore, going over to diminishing balance depreciation, for income tax purposes, with rates presumably adequate to write assets down to scrap value by the end of their economically useful life.

Is It Necessary?

If, for income tax purposes, adoption of the diminishing balance method is the only means by which the income tax authorities can be induced to make any allowance for losses due to obsolescence, then, for these purposes only, the old, out-dated method must be accepted. But surely this is not necessary. Normal obsolescence can be provided for by allowing a sufficiently generous annual depreciation rate on the straight-line basis, and it should be possible to allow for any abnormal loss at the time the asset is discarded. South Africa adopted the policy, some years ago, of so adjusting matters: if the asset is sold for a figure *above* that to which it has been reduced by income tax allowances, the excess is taxable to the extent that it has been allowed as depreciation in the past, while if the amount recovered is *less* than such figure, the difference is allowed as a charge. The Minister of Finance's "recapture" provision, under the new scheme, is on similar lines. Apart from this question of income tax the great danger is that, since Canada has so long been used to the situation under which nothing was allowed for income tax purposes unless it was in the books, there may soon be a move for adoption of the same system for general accounting purposes in Canada.

U.S.A. To Follow?

An article by no less a person than Mr. George D. Bailey, C.P.A., past president of the American Institute of Accountants, in *The Journal of Accountancy,* November 1949, seems to indicate that the diminishing balance method may become generally popular throughout all North America. Speaking of the post-war period, he accuses the straight-line method of a "lack of realism in the sense that the business decisions operating to acquire properties in most businesses were not made in the belief that there would be a ratable usefulness of those facilities over a full theoretical life. What attempts there had been in years past at a reconcilement of business practice and depreciation rates had been pretty well driven out by tax laws and regulations". He attributes the undercharging for depreciation provision in these years partly to the replacement problem (i.e. falling money values or rising prices), partly to the greater productive use of facilities, and partly to increased economic uncertainties. In the end, after considering ways and means of fitting accelerated depreciation "into corporation accounting on some logical basis", he ends with the ominous suggestion: "Perhaps the easiest way to do all this would be to adopt *the good old policy* of depreciation on the diminishing balance. Geared to an eight, or ten year life, *the amounts in the early years would be substantial and perhaps adequate*".

British Experience

Now why, oh, why does one country not show more awareness of what has been learned by long and bitter experience in another? It is a very clearly established fact that Britain has proved, by decades of use, that the diminishing balance method is wholly unsatisfactory. She clung to it until she was forced to abandon it, yet we hear no word of that on this side of the Atlantic. Briefly, the arguments against the method may be stated as follows:—

(1) It is too simple and makes for bad accounting from the point of view of historical records, plant registers, etc. — the "lazy accountant's friend".

(2) To write an asset down to scrap value in the same time as the straight-line method, the percentage rate must be 2½ times as great. In practice the average user will overlook this and underprovision for depreciation will result.

(3) If the rate is adequate it will be so large as to result in very inequitable distribution of the charge for depreciation against annual production. If the rate is much lower it will leave a balance far above scrap value at the date of disposal of the asset.

(4) Hidden in one composite asset figure, comprising units bought at widely differing rates, the book values of assets may tend, as the years pass, to cover more and more unwritten-off balances of old, long-disposed-of assets. It may be said that accountants will guard against this, but this is not so easily done in the large numbers of smaller business concerns. It will be found in practice difficult to identify depreciation reserves against the corresponding specific assets.

Born at Durban, South Africa, Professor Kenneth F. Byrd, M.A., B.Sc. (Econ.), returned to Natal in 1929 as lecturer in accounting and auditing at Natal University College, having received his early and college education in England. He was Dean of the Faculty of Commerce and Administration at Natal University College on his appointment as Professor of Accounting at McGill University in 1949. He is a member of the Natal Society of Accountants and of the Institute of Chartered Accountants in England and Wales.

ILLUSTRATION

Year	% age of efficiency in operation	(a) Apportionment of total depreciation in the ratio of proved efficiency	(b) Straight line Deprecia-tion	Divergence (b)-(a)	(c) Diminishing Balance Depreciation 25%	Divergence (c)-(a)
1	90	$1,017	$1,000	$— 17	$2,625	$+1,608
2	100	1,130	1,000	—130	1,969	+ 839
3	100	1,130	1,000	—130	1,476	+ 346
4	100	1,130	1,000	—130	1,107	— 23
5	95	1,074	1,000	— 74	831	— 243
6	90	1,017	1,000	— 17	623	— 394
7	85	960	1,000	+ 40	467	— 493
8	80	904	1,000	+ 96	350	— 554
9	75	847	1,000	+153	263	— 584
10	70	791	1,000	+209	197	— 594
		$10,000	$10,000	$ 996	$9,908	$ 5,678

The British Institute recommended: "Details of all fixed assets should be kept (preferably in registers specially maintained) to show the cost of each asset, the provisions made for its depreciation and the basis of the provisions made". One of the great advantages of the straight-line method is that it makes the keeping of a detailed plant register, with columns provided to give particulars for each year, virtually a necessity. This will reveal the true position of each item of plant at any time and ensure that depreciation provision ceases as soon as provision has been made for the full cost of an asset. Will the relaxed discipline of the diminishing balance method not almost certainly mean a falling off in such meticulous records, a tendency to take advantage of the fact that this method is never in danger of writing an asset completely out of the books while continuing the annual charge long after its disappearance?

An illustration can demonstrate the fact that the diminishing balance method cannot normally be more equitable than the straight-line method. Let us take the case of a machine which costs $10,500 and which has an estimated useful life of 10 years, after which its scrap value will be $500. (*See illustration above*)

In the above table the sums, irrespective of their positive or negative signs, of the divergences in the two columns, give some indication of the relative extents to which the two systems result in charges unrelated to output. The sum of the annual errors in apportionment under the diminishing balance method is as large as 5678, out of a total amount for distribution of 10,000, as compared with only 996 under the straight-line method. Also, the annual range of error is from 160% above to 75% below, under the diminishing balance method, as against 1.7% below to about 25% above under the straight-line method. In the nature of things no method of depreciation can be exactly accurate in its results, but the straight-line method minimizes the inaccuracies over which the diminishing balance method rides roughshod. It has been assumed in this illustration that, after the initial period of adjustment, efficiency of operation will

remain at its maximum for about half the asset's effective operating life, and will then decline year by year until, at perhaps 70% efficiency, it becomes economically expedient to replace the asset. It should be noted that, in this illustration, even a rate of 25% did not wholly succeed in reducing the asset to scrap value in 10 years. The rate used in practice is likely to be much smaller. A rate of 10% under this method would require 28 years for the writing[2] off of the asset. To illustrate the tendency it can be shown that if the unrecovered depreciation, where the rate is too low, is not written off in the books, the result will be as follows. The book value of the asset, assuming for simplicity an annual addition equal to the cost of the original asset, will accumulate year by year until the capitalized value is stabilised at that figure on which the rate of depreciation used gives the true annual depreciation. There will thus be a large, hidden capitalisation of what is not, in fact, an asset but deferred depreciation.

Obsolescence

It is said, and on this the Minister of Finance has based his decision, that the risk of obsolescence has its greatest incidence in the early years of an asset's life. It is, of course, true that the effect of sudden unforeseen obsolescence will indeed be greatest in the early years. But it is not possible, in the financial accounts, to provide for such abnormal obsolescence as a direct charge in the costs. Normal obsolescence, according to the type of industry involved, will be provided for in determining the anticipated effective operating life of the asset and its scrap value at the time of ultimate disposal. The question of the date at which an otherwise sound asset, in good operating order, should be scrapped to allow for replacement by a modern asset, capable of a better performance, is one to be decided by expert engineers and accountants, having regard to costs, including an imputed interest charge on invested capital, increased output, general efficiency of performance, etc. No method of depreciation provision can be other than approximate, having regard to this risk of obsolescence. But, on the basis of an anticipated effective working life which has taken all this into account, the straight-line method is much more equitable than the diminishing balance method. At no stage can the latter have other than a purely fortuitous close relationship to the actual depreciation facts for any given accounting period. The straight-line method, on the other hand, can easily be adjusted for any marked change in actual usage—as, for example, by the provision of a year and a quarter's charge if, in any year, the normal anticipated machine-hours are exceeded by 25%. It is quite easy to keep the depreciation provision in line with that portion of the anticipated life which effectively passes during the accounting period. From an accounting point of view the proper way to provide against the risk of abnormal obsolescence is by way of a special reserve, built up out of profits, against the day when the obsolescence takes place, similar to the equalization fund suggested by *The Accountant* to deal with annual repairs.

Confusion with "Accelerated Depreciation"

There is a tendency in some quarters to class the diminishing balance method with "accelerated depreciation", which is being adopted in the United States as a means of providing an extra charge in periods of excess production. The effect of each method may, it is true, be similar. Accelerated depreciation normally results from much higher than normal percent-

[2] P. D. Leake: "Depreciation and Wasting Assets". (Gee & Co.)

ages of cost written off in the early years, but the method of depreciation may still be basically straight-line with a proportionate increase in the year's provision to keep it in line with abnormal production. The United States Steel Corporation has been induced by the Securities and Exchange Commission, under protest, to adopt this method instead of its former provision, in 1947 and the first three quarters of 1948, of normal straight-line depreciation plus, in 1947, an extra $26,300,000 as a reserve for replacement. In so doing it has adopted a policy similar to that already approved for the Chrysler Corporation. But clearly these companies have not made a permanent change in their method of depreciation which is, presumably, still basically straight-line. U.S. Steel will use the new basis as long as its operations are in excess of normal, and Chrysler has tied it to excessive construction costs. If normal conditions return they will both return to their normal methods. The serious thing about the proposed change for Canada is that it is a permanent shift from "straight-line" to "diminishing balance" depreciation.

A Wolf in Sheep's Clothing

It must be noted that this discussion has not been intended to cover the question of depreciation in times of rapidly falling monetary values, and the whole vexed question of provision for replacements under such conditions. Accelerated depreciation, or any other method of writing off against revenue the historical cost of an asset, affects only the distribution of such cost — it can do nothing to provide for the increased costs of replacement. This is the problem which, above all others, demands solution by the accounting profession in the present day. U.S. Steel Corporation made a commendable pioneer move but was brought to heel. However, that matter belongs to another story and must not be dealt with here. The immediate danger is that Canada may, in an ill-advised moment, lose the benefits which she has thus far gained from her long adherence to straight-line depreciation. Let her give heed to the experience of those who have learned that the "lazy accountant's friend" is a wolf in sheep's clothing.

Silence Is Golden

A Toronto firm of chartered accountants recently had one of their account verification forms returned unsigned by the debtor, with a note on the back which read as follows:

"From my side of the fence, you are paid to audit. Please do it and don't ask me to help you."

The Expanding Responsibilities Of the Public Accountant

By L. N. Buzzell, C.A.

The accountant's obligations to society as well as to business

WHAT is the responsibility of the accounting profession in and to this troubled world? That is a question we must continually ask ourselves and study, because, while our profession is numerically small, it is comprised of individuals whose minds have been trained to observe and to analyze, to expose deceit and support honesty, to disentangle facts from webs of fancy and to "debunk" unsound theories. Nothing is likely to be more important to the progress of the world than minds that can reason, backed by hearts that have the courage and the unselfishness to give force to that reasoning.

This Troubled World

It is not my purpose to gaze into a crystal ball and try to foretell the future, but neither crystal balls nor any other paraphernalia of the soothsayer are necessary to inform us that a new and troubled era has dawned and that the problems attendant upon the state of war were small in comparison with those of its aftermath. Nor can it be safely argued that that aftermath will not outlive everyone living in Canada to-day. If, in the end, out of this mess there shall emerge the brave new world we hear about, it will be due, not to psalm-singing ideologists or to mouthing mountebanks, but to the clear thinking of reasoning and reasonable minds, to men who have the ability to think straight and the fortitude to back it up. And that's where the chartered accountant comes in.

Not for one moment is it suggested that this is a job for chartered accountants only. I am not comparing our profession with other professions or trying to establish our qualifications as being above or, for that matter, equal to the qualifications of other individuals. This is merely an endeavour to show that the accounting profession may, if it so elects, — and it is to be hoped that it will — make an important contribution to the shaping of the post-war world.

During the six years of war we learned that we had a public responsibility to fulfil beyond the generally accepted boundaries of our profession and that we could fulfil it. With a few notable exceptions, before the war the accounting profession stuck pretty close to its own knitting and played a relatively

A paper read at the Maritime Chartered Accountants' Conference, Saint John, Oct. 1949

unimportant part in public affairs. True, we served on various charitable and public service bodies, largely municipal in their scope, but our advice and assistance, when sought or offered, was usually confined to subjects that came within the scope of our professional activities. To only a few did it occur that we had a larger national duty to perform. During the war, however, chartered accountants found themselves in large demand in the national field, not merely in accounting capacities but in high administrative posts as well, where theirs was the responsibility for big decisions and where they discharged their duties with honour to themselves and our profession.

History has moved faster than men. Events have outraced minds. Those in this country who can see the new order of things, who are prepared to accept them and to attune their thinking to them, are few in number. This profession of ours can increase that number. We have the training to discover and to assay facts and we can use this acquired knowledge to give leadership. We shall be derelict in our duty to our profession and to ourselves as citizens if we do not use these talents to that end. Those who bore arms in the war have long since laid them down, but upon those who provided leadership still rests the onus of leading and we, as a profession, were in the van among that number.

Our Liabilities

So far mention has been made only of our assets. Nothing has been said of our liabilities, but these must not be overlooked. Of necessity, our profession is a precise one, and as such it is apt to produce precise minds. No matter what the dictionary may say, too often there is little difference, in practice, between a precise mind and a rigid mind. That is a danger we must recognize and endeavour to avoid. Of appeasement we want to hear nothing more. We have had enough of that. But of tolerance we want to hear much more than in the past. You cannot sharpen your mind by narrowing it and, in the long run, provide successful leadership. The broad view, the tolerant one, is the only sure signpost to successful leadership, and for many of us in this profession that will be a difficult lesson to learn. However, since some of us in wartime demonstrated beyond argument that it could be learned, surely the profession as a whole can master it too if we set our minds to it in preparation for the role we shall be expected to assume as the great drama of this country's future is played on the world's stage.

Fitness to shoulder responsibility within the large national and international arenas is not lightly acquired. Penicillin cannot cure ignorance, and the qualities of leadership cannot be grafted on to human beings like monkey glands. Leadership, except in the most brilliant, is learned in a hard, long school, but the fact that it is hard and long doesn't mean that it is unimportant. The fact that it has provided the way to larger spheres of influence proves it. *All* the post-war problems are not national and international. There are crises to meet in municipal and provincial affairs that are just as acute and just as important as those in the wider field. Therefore, we should not scorn the smaller field because we do not happen to be ready or to be accepted for the larger. Wherever leadership is required, there our profession should be found providing it.

Now, where do the accountants and the accounting profession fit into the present and future picture? As stated,

they have an obligation to the community and their main responsibility, of course, is to their clients.

Responsibility to the Public

Let us first deal with their obligation to render public service to the country at large and to their own community.

The day is not far distant when the force of events will compel the various governments of Canada to seek more and more the advice of public accountants as to the solution of the problems which confront them. Their solution, as in private affairs, is always dependent upon the disclosure of the pertinent facts, and that is where we come in. Our responsibility is to take a lead in helping to solve the problems of this country, not only as experts but also as good Canadians.

We should, among other things, continue the practice of the war years, when, to help the country's war effort, members of the profession accepted positions in the Department of National Defence, the Foreign Exchange Control Board, the Wartime Prices and Trade Board, etc.

It is also our duty to give to the Government advice on such matters as taxation. How can this best be done?

The D.A.C.A.

Three main phases of endeavour can be undertaken by The Dominion Association of Chartered Accountants, of whose part in the formation of the Canadian Tax Foundation we are all proud. First, the Association must continue its present policy of employing a full-time personnel with the capacity and vision to take the lead in constantly expanding its usefulness. Secondly, the larger firms of accountants particularly must make available the services of a partner to carry on the committee work successfully.

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Thirdly, the profession must keep up the good work that has been done by such committees as those respecting legislation, accounting research, post-war planning, and co-operation with stock exchanges.

Accountants are going to be called upon more and more to act as members of Government commissions such as the Royal Commission on the Taxation of Annuities and Family Corporations (the Ives Commission). In matters of this kind, their duty will be to gather all the pertinent facts, irrespective of political considerations, and to form sound conclusions based upon those facts.

Serving On Public Bodies

Another example of the duties which accountants will be asked to perform is acting on such bodies as hydro-electric and other public works commissions.

In work of this kind the accountant's responsibilities are:

1. To do his best to assure a sound administration of these bodies and to resist any political influences which would affect efficient operations;
2. To see that in the expropriation of properties reasonable compensation is paid the owners, so that both they and the taxpayers are fairly treated;
3. To encourage the introduction of good employee working conditions, including adequate salaries, hospital care, pension plans, etc.

Another type of work which ac-

countants will probably be asked increasingly to undertake is the independent audit of provincial Governments and large cities. Here his obligation is to present the financial statements of these bodies in a clear and concise manner which can be readily understood by financial analysts and the public generally. The published accounts of a Province or a large city should be just as simply presented and its financial standing and annual operating results be as readily understandable as those of any public company.

There is a field for accountants to act as advisors to trade associations in questions of allocation of markets and prices (within the boundaries of the *Combines Act*), as well as in such matters as uniform methods of cost accounting and presentation of financial statements.

They will be called upon more and more to act as professional directors of both private and public corporations (always subject to the limitation that they cannot be both auditor and director of a public company). There is no reason why they should not accept this office, as their knowledge of and experience in financial matters can sometimes prove of great assistance to the directors in forming sound policies for the company and thus protecting the shareholders' and creditors' interests.

Turning to community activities, accountants have an obligation to fulfill in local affairs. They should accept appointments on such bodies as hospital, school and public charity boards. They can bring to these positions a knowledge of sound accounting practice and finance which may prevent these institutions from making serious errors of policy. Their advice may not always be followed, but there certainly is no harm in their trying to make a contribution.

Responsibilities In Practice

Now let us examine the accountant's obligations in work which he carries on in his daily practice.

He must first secure and retain the confidence of his clients without which his influence and his usefulness are negligible. How can he do this? The answer is by being perfectly honest in his advice to and relationship with them and by being sympathetic to their point of view.

The professional accountant should avoid going into "deals" or business ventures personally with his clients. This practice tends to destroy his professional relationship with them and makes it difficult to give sound impartial advice and to maintain that attitude of constructive criticism which is the public accountant's chief asset. We are paid to criticize, not to agree.

Let us now turn to the various duties the accountant will be asked to perform for his clients:

Issues of Securities

First, in the matter of the public issue of securities, he will continue to be requested to undertake the very responsible work of examining the accounts of companies and furnishing certificates of financial standing and records of earnings. This field breaks down roughly, into the following parts:—

1. Advice regarding the purchase of companies with a view to public financing;
2. Advice as to what price should be paid for such companies in order that the proposed issue of securities may be sound;
3. The actual investigation of accounts for the purpose of preparing, for a prospectus, a certificate of earnings and financial standing.

Business For Sale

Accountants are in a unique position, because of the confidential nature of their work, to know of companies that are for sale and of prospective purchasers. Often they can act as intermediaries in working out a constructive arrangement, and it is their responsibility to do so. Clients often appreciate an auditor having an eye to their business interests much more than they do the preparation of the annual statements. Too often we hear people say that their auditors have never in years made a single constructive suggestion.

The second point as to the price which should be paid for these companies requires very nice judgment. Here four factors come into play — the present net worth of the companies, their past records, their future prospects, and the management. These must all be weighed. A wealthy company with a poor record of earnings and indifferent management may not be a good risk. On the other hand a company with a poor equity position but with aggressive management and good future prospects may well warrant the payment of substantial goodwill to acquire it. The accountant's advice will invariably be sought on the matter, and it is his duty to be sufficiently alert and in possession of all the facts to express a sound opinion.

As to the investigation of the financial position and the preparation of a record of earnings, even if the accountant is asked to certify only to five years' earnings, he would be wise to prepare from audited statements, if available, a statement of sales, expenses and the ratio of average earnings to capital invested for the past 20 years. This reveals the record of the company through at least two business cycles and is information which is not only of great interest to the prospective purchaser but also valuable in assessing the worth of the company and its future prospects. When an accountant is preparing his certificate of earnings, he should never allow himself to certify to earnings before provision for depreciation and income and excess profits taxes (unless, in the case of income and excess profits taxes, the securities which it is proposed to issue are in the form of bonds or debentures). He should be careful about certifying to earnings after eliminating "non-recurring expenses". It is his duty not to prophesy but to stick to facts. When vendors of securities urge an accountant to "gild the lily", he should usually "smell a rat" somewhere.

Supervising and Liquidating

Another important phase of accountants' work is the supervision of sick companies for creditors and the liquidation of businesses. The supervision of sick companies is the most fascinating and responsible work that an accountant is called upon to perform. When dealing with such a company, his opinion is often final upon such vital questions as: "Can the company pull through or should it be sold to stronger financial interests?", "Is the management sound?", "Has it any future prospects?" and "Had we better take our loss now?". In cases of this kind, it is usually best to allow the present management to continue for a period of six months to a year after a definite objective of sales, expenses and profits has been set. If this objective is not met, the management should be changed and a last effort made by new management to save the situation. Professional accountants should adopt a general policy of exhausting every effort to pull a company through, before recommending that it be liquidated. Bankruptcy is like litigation — everybody loses. The responsibility of the accountant in this type of work is very great, but there is no thrill equal to that of seeing a sick baby restored to

health. The reward to the accountant (in addition to his fee) is that there is nothing that enhances his reputation like success in a few of these "salvage" jobs. They mean more to the business community than any number of carefully prepared annual balance sheets.

When all efforts have failed to save a business, it must be liquidated. Here the accountant steps from the post of advisor to that of administrator. It is now his duty, with the advice of his inspectors, either to sell the assets as quickly as possible for the highest price he can obtain or to work out a plan of reorganization which will rehabilitate the company. Here again, the accountant will stand or fall by the integrity he displays and the business acumen he shows in dealing with bankruptcy situations.

Duties To Clients

The accountant's obligations to his clients in his more or less day-to-day relationships with them can be grouped as follows—

(1) *Audit procedure and preparation of annual financial statements*

Here the accountant must always keep an open mind and never degenerate into a routine checker. An annual audit with out the introduction each year of some constructive suggestion regarding accounting procedure, internal check, methods of costing, etc. can be largely a waste of his time and the client's money.

(2) *Income tax matters*

The primary obligation of the accountant here is to persuade his client that the line of over-conservatism, as regards inventories especially, should not be crossed. A formula often used in this instance is to tell a client that his inventories should be valued at a figure which he can conscientiously defend. The auditor can quite properly go a long way towards meeting his client's wishes in the presentation of his statements, if the statements and report state fully and fairly the basis of valuation of the assets. In this way, he can retain the confidence of both client and taxing authorities and make a valuable contribution in helping to straighten out contentious matters which from time to time arise between them.

(3) *Negotiation of cost plus and other contracts*

The basis of all these negotiations is always fact. The accountant must first of all make himself thoroughly familiar with the case and then stand his ground. Even tough negotiators can be softened up when presented with facts and figures by a resolute businessman backed by his auditor. This principle also governs contracts which are being negotiated on a cost plus basis or any other basis involving the element of profit. There is nothing that helps more to complete the harmonious arrangement of such contracts than a complete and honest preparation and presentation of all the facts relating to the situation.

(4) *Clients' employee relations*

The auditor will frequently be consulted by his clients on such questions as whether they should establish pension funds, hospital services and wage incentive methods. In this regard he should advise his clients to do everything they possibly can within their financial capacity for their employees. First of all, it is good business, as contented employees usually mean a successful company and good public relations. Secondly, the client might as well do it gracefully and receive the "kudos" for having originated the idea, as he will probably be forced into it anyway in this present world in which we are living.

(5) *Cost accounting and management consulting*

Professional accountants are going to be asked more and more to advise in

this very important field if they are competent to do so. I am afraid that the profession, by and large, has, to date, failed to prepare itself in this sphere. Until we do so, we shall continue to see our clients engage other people to do, in many cases, work in a field in which we should be the recognized experts.

(6) *Advice in executorship and trustee work*

Our work as advisors in this field is bound to increase. We should be well qualified to negotiate with succession duty authorities regarding the valuation of shares of private companies and other assets, where no rule-of-thumb valuation exists. Public accountants should also be qualified to plan and advise in the administration of estates, but before we are recognized in this field the public must share this opinion.

(7) *Labour unions*

I shall even have the temerity to suggest that accountants may be called in more and more to audit the accounts of labour unions and to establish records for them which will properly reflect their operations. Labour unions should be governed by Government charter and be subject to the same controls, such as independent audit, as limited companies. The unions must establish financial responsibility to meet their obligations in the event of the violation of their contracts with business, such as wild-cat strikes, etc. Until labour leaders come to a realization of these facts, Canada may well be the scene of labour troubles which may seriously disturb our economy. Our profession may have an important role to play in guiding labour along these lines.

Closing The Profession

I should like to deal with just one other matter and that is the question of the closing of the public accounting profession.

For many years, accounting societies have regulated the conduct of their members and established codes of ethics and standards of competence. Thus, today when the public employs a member of one of the recognized professional accounting societies they may reasonably expect a minimum standard of proficiency. With the growth in the demand for public accounting services, a number of so-called accounting societies have been organized which do not require of their members any special knowledge or training and which do not have any uniform standards of measuring the ability of their members to conduct a public accounting practice.

This situation has led to a certain amount of confusion in the eyes of the general public. While bankers, industrialists and executives in larger commercial enterprises are doubtless well aware of the differences between members of one accounting society and another, this is not true of the public at large, which today is turning more and more to professional public accountants for assistance and advice on taxation and business problems.

In recent years there has been a growing feeling, both in the ranks of the public accountants and in the minds of the public, that professional accountants who offer their services to the public should be required to pass certain proficiency tests to ensure that those who employ them are, in fact, employing accountants competent to deal with their problems.

There is no unanimity of thinking in the ranks of professional accountants as to the advisability of the regulation of the profession by the state. Furthermore, even among those accountants who feel that a measure of Government regulation and control is desirable, there are differences of opinion as to the methods which they believe should be adopted. However, a number of States south of

the border have enacted a measure of control whereby professional public accountants are licensed by the State. As you know, regulatory legislation has been enacted by Quebec and Prince Edward Island and is under consideration in most of the other Provinces. While some Provinces may not pass legislation on the subject in the near future, it is bound to come eventually, and the professional public accountant must make up his mind as to the measure of state control which is desirable and use every effort to encourage legislation to bring about such control.

The only suggestion I have to make is that it is in the interests of all qualified accountants to make sure that any legislation which is passed does not set up artificial barriers which will restrict the practice of qualified men and women to any particular area. In other words, such legislation, as and when it is passed, should allow any qualified public accountant in Canada to practise anywhere in the country and should permit qualified non-Canadians, who move here, to be licensed on some reasonable and practical basis which will not require further long terms of service nor the passing of examinations by men who have already proved their ability in some other country.

Conclusion

To conclude—

(1) The accountant cannot escape his responsibilities. The business community is coming more and more to expect him to develop an organization which not only can handle the ordinary day to day audit work but can also take command of any difficult situation.

(2) The opportunities of the accounting profession are great. Can we grasp them? The answer is—"Yes, if we show the necessary vision, courage and capacity". The surest way for the profession to become a powerful factor in the business, social and national life of Canada is to enroll in its ranks the brightest and most courageous of our Canadian youth and to train them so that they will have the character, capacity, courage and vision to render sound and honest judgment on the social and economic problems which we face in this country.

Obituary

Wilbur Francis Chown

The Institute of Chartered Accountants of Ontario announces with deep regret the death, after a short illness, of Wilbur Francis Chown at Ottawa on January 8, 1950 in his fifty-fourth year. Mr. Chown was born in Kingston and attended school there. On his return from overseas service in World War I he entered Queen's University, obtaining his B.A. degree in 1922. After a year at the Ontario Agricultural College he took up farming near Whitby, Ontario and at the same time studied to become a chartered accountant graduating in 1934. In 1935 Mr. Chown went to Ottawa to join the Agricultural Economics Division of the Department of Agriculture. During World War II he served on the War Time Prices and Trade Board and was appointed deputy foods administrator in 1947. At the time of his death he had been named technical advisor to the Royal Commission recently appointed to inquire into the cost of living in Newfoundland. To his wife and the members of his family, the Institute extends sincere sympathy.

Controllership

By Frank S. Capon, C.A.

The functions of a controller in the administration of business

THE POSITION of controller has not yet been developed in Canada to the point where it means the same thing in all companies. A controller may be a bookkeeper, he may be an auditor or he may be the chief financial officer of a company with vice-president status. When I use the word "controller" I am talking about the man directly responsible for all accounting and financial phases of his company's operations. In many Canadian companies his title is treasurer, in some cases it is even secretary and, actually, in very few is it controller. The title has been more fully developed in the United States and I have no doubt that the Canadian trend will follow the U.S. pattern.

Throughout my discussion I want you to bear in mind one essential point. The controller is an administrator first and an accountant second. Except in the smallest companies, his job is to get work done and not to do it himself. The most capable accountant cannot become a good controller unless he is first a good administrator.

The Controllers' Institute, which operates for controllers in much the same way as the Institute of Chartered Accountants operates for professional accountants, has defined the responsibilities of the controller under six main headings. I can do no better than to use this definition as the basis for my discussion.

Planning

The first responsibility is:

> To establish, coordinate and maintain, through authorized management, an integrated plan for the control of operations. Such a plan would provide, to the extent required in the business, cost standards, expense budgets, sales forecasts, profit planning, and programmes for capital investment and financing, together with the necessary procedures to make the plan effective.

Owners, through their directors, set the broad policies governing the manner in which the company shall operate. Within these broad policies the controller must draw a detailed plan, budget or forecast for management to approve. He must then institute the necessary procedures to see that all sections of the company are aware of the approved plan, understand it, and report adequately on their accomplishments. He must satisfy himself that all sections of the company are operat-

An address to the Chartered Accountants Students' Society of Quebec, Nov. 1949

ing according to the plan. To achieve this he must use all the techniques instilled into him during his accounting training, but the information on which his plan must be based must inevitably be obtained from sales managers, production managers and other operating personnel. The plan of operations does not limit itself to sales and cost budgets for one year, since it must also cover the company's capital requirements to meet expanding operations. In bigger companies it is usually necessary to plan from three to five years ahead for capital requirements, as it often takes this period to make the necessary arrangements to obtain new financing.

Reporting

The second main responsibility is: **To measure performance against approved operating plans and standards and to report and interpret the results of operations to all levels of management. This function includes the design, installation and maintenance of accounting cost systems and records, the determination of accounting policy and the compilation of statistical records as required.**

It is not enough for the controller to draw the road map for his company. He must then report regularly to management on the way in which the sales, production and other operating managers are carrying out their respective parts of the overall plan. He must design and install all of the various cost and general accounting systems which are necessary in order to provide him with the information he needs for the purpose of making these reports to management. He must establish the accounting policy of the company in order that these accounting records can be prepared consistently in all offices.

This second responsibility also includes the annual report to shareholders. I must emphasize here that the company's official financial statement, which is certified by its auditors and released to its shareholders, is prepared by the company and not by its auditors. While it is true that many small companies who do not employ a full-time qualified controller rely upon their auditors to prepare their financial statements, the responsibility for preparing these statements is placed by the *Companies Act* on management. The auditor is required to report on the statements prepared by the controller, but it is the controller who must prepare them in accordance with the accounting and financial policy of the company.

The Unvarnished Truth

In reporting to management on operating results, the controller must be factual and objective. He must tell the unvarnished truth, with the best explanations available, but never with alibis or excuses. To illustrate the need for truthful reporting I can do no better than mention a recent cartoon in *The Financial Post.* There is a picture of the president seated at the head of a table surrounded by directors and commenting on the controller's report as follows — "Gentlemen, we are obliged to report that the controller has been playing poker with company funds — which accounts for our abnormally high profit last month".

It is in this phase of controllership where we industrial accountants come very close to the professional accounting institutes. The controller must establish his accounting policy in line with the best interests of his particular company, but he must at the same time bear in mind the broad standards of accounting laid down by the professional accounting institutes. Frequently, we in industry are faced with new accounting decisions. For example, right now

we have to decide how we will reflect in our accounts the new depreciation basis which is to be allowed for tax purposes. In future, we believe depreciation is to be calculated for tax purposes on the decreasing balance of assets after writing off the previous year's depreciation, but depreciation rates will be about twice as high as before. While this situation is to be allowed for tax purposes, accountants have for many years accepted the straight-line basis as the proper method to be used generally for the calculation of profits. To comply with generally accepted accounting policies, industry should continue to use straight-line depreciation methods in its accounts, but for financial reasons it will almost certainly use the decreasing balance method for calculating its tax liability. The result will be a substantial tax saving in the early years of new plants, to be followed at a later date by tax payments in excess of the amount calculated according to the profit for the year based on straight-line depreciation. The question arises — is this initial tax saving a profit in the year in which it is realized or is it a deferred liability to be set aside in the accounts and paid over at some future date? The professional accounting institutes have not yet issued any statement of policy on this new problem which must be faced by every company in Canada. Controllers must soon make up financial statements based on these new rules and they must bear in mind that these statements are to be certified by their auditors and must conform to general accounting principles.

This is one instance of the type of accounting decision which must be made by the controller and, since many of these decisions affect all companies, the controller relies heavily on the professional accountants for guidance and

Formerly with the Montreal firm of Riddell, Stead, Graham and Hutchison, Chartered Accountants, Mr. Frank S. Capon, C.A., joined Canadian Industries Limited in 1938. In 1949 he was appointed treasurer of that firm. He is a member of the Quebec Institute.

support. The Controllers' Institute, which has only recently been formed in Canada, should go far towards coordinating the thinking of business accountants and making it possible for them to express official coherent views. It is to be hoped that this mechanism will make it easier for business accountants and professional accountants to exchange views and to reach well-considered opinions before it is necessary to release financial statements based on new accounting principles.

Reviewing

The third responsibility is:

> To measure and report on the validity of the objectives of the business and on the effectiveness of its policies, organization structure and procedures in attaining those objectives. This includes consulting with all segments of management responsible for policy or action concerning any phase of the operation of the business.

In this instance the controller ceases to be an accountant and becomes 100% management. His job is to view the overall policies and objectives of his company with a view to giving both destructive and constructive criticism. He must measure his company's objectives in terms of the political atmosphere, the economic environment, and also the various statutes under which his company is operating. He must be able to measure the effectiveness of the company's organization structure and also the manner in which its organization goes about attaining the objectives

set down by administrative management.

Returns

The fourth responsibility is:

To report to government agencies, as required, and to supervise all matters relating to taxes.

This field includes all of the many reports required of business today by such agencies as the Income Tax Division, Sales Tax Division, Workmen's Compensation Boards, Unemployment Insurance Commission, Dominion Bureau of Statistics, Foreign Exchange Control Board, Wartime Prices & Trade Board, and many others in the federal and provincial fields.

By far the most important of these reports is the income tax return requiring, as it does, a thorough knowledge of complicated tax legislation. In this field the controller's responsibility is not limited to the preparation of the company's tax return. He must ensure that every phase of the company's operations is being carried out in a manner designed to minimize taxation. He must have an intimate knowledge of the application of all taxing laws to the company's entire operations, and at times he must act as policeman for the Government as well as for management. He must know that it is in his company's interest to observe the law — pay as little tax as legally possible, but never try to beat the law illegally. He must establish good relations with taxing authorities at all levels of government and gain their confidence — it is these good relationships which go far to minimize taxation for any company. I personally have found practically all Government officials to be fair in their interpretations of the law, and I am sure that a taxpayer seldom loses by putting up his case where there is doubt and arguing it out. For a controller it is not smart to beat the tax laws illegally, and the Controllers' Institute is making every effort to ensure that its members are regarded by Government as responsible officials of quasi-professional standing who can be relied upon by both Government and management.

Interpreting

The fifth responsibility is:

To interpret and report on the effect of external influences on the attainment of the objectives of the business. This function includes the continuous appraisal of economic and social forces and of governmental influences as they affect the operations of the business.

I mentioned briefly above the review of the overall objectives insofar as they were affected by economic and social forces. This fifth responsibility is a more specific application of the general rule. The controller must be in a position to report on the effect of such external influences as general economic conditions, governmental and social planning, export and import situations, political developments, and so forth, and in this field the controller of the bigger company must have a full-time qualified economist on his staff. In Canada, as in the U.S., the controller must always be conscious of such factors as anti-combine laws. He must satisfy himself that his company is not contravening these laws and it is upon him that the burden of proof falls when the Combines Investigation Commissioner chooses to turn the spotlight on his company. In recent years, business has been subjected to many inquiries of one type or another. We had the preliminary committee on prices, the Royal Commission on Prices, the inquiries into freight rate increases, the Royal Commission on taxation of personal corporations, and many others, and in almost all cases the burden of producing the business figures required

by these committees and commissions fell upon controllers.

Protecting

The sixth responsibility is:

> To provide protection for the assets of the business. This function includes establishing and maintaining adequate internal control and auditing, and assuring proper insurance coverage.

This last heading reverts to one of the first responsibilities of accountants in business, that is, to accept the original capital from the shareholders and to assume responsibility for safeguarding that capital so far as possible against theft, improper use or loss by fire or other accident. The controller does not assume responsibility for the loss of money through unprofitable operations unless his own inadequate accounting or reporting system is indirectly responsible for such losses. He is, however, responsible for seeing that operating capital is adequately insured against all risks and that readily disposable assets are protected against theft or misappropriation.

Those are the six main responsibilities of the controller of a company. The most important responsibilities are undoubtedly those of an accounting nature, although the responsibilities concerning the analysis of external economic and social factors and the compliance with taxation and company laws can hardly be overestimated.

Education

Concerning the matter of education for controllership, the accounting knowledge must be obtained through the C.A. course or some other formal accounting course. However, much of the controller's ability must be developed on the job, for our C.A. course is woefully deficient in the aspects of advanced financial analysis, report writing, and particularly in managerial functions. It is, of course, recognized that the C.A. course is designed to train professional auditors and not controllers. This was clearly brought out by Mr. Warren Nissely, chairman of the American Institute's Committee on Selection of Personnel, at Michigan University last spring when, in objecting to combining courses aimed at training both industrial and professional accountants, he said: "One of the reasons for separating the groups is that those in our group just have to have a superior intellect, and it is more efficient to teach such a group together". Well, maybe it is! Maybe we shall eventually have to persuade our universities to develop courses in industrial accounting, so that controllers can be drawn from such courses rather than from the professional auditing firms. Personally, I hope not. I think that a free exchange of thought, and even of positions, between professional and industrial accountants will be to the mutual benefit of both.

Many new members of the accounting bodies will take jobs in industry after they have completed their accounting training. Some will go into small companies where a qualified accountant can undoubtedly fill the controller's position regardless of his administrative ability, because he will actually do most of the work himself. Some will go into larger companies where the opportunities for accountants are by no means limited to accounting jobs but where the top accounting job is primarily administrative.

Large and Small Companies

The problems of management in the larger company are infinitely greater than in the smaller company and the extent to which the administrative requirements of the controller's job outweigh the accounting requirements in-

creases with the size of the company. In the largest companies it sometimes happens that the top financial officer is not even an accountant, as evidenced by the case of one of the largest U.S. corporations which recently appointed an engineer as vice-president and treasurer. The qualified accountant in the large company may find himself apparently stuck on a technical accounting job while others by-pass him to take the more senior administrative accounting job. Those who go ahead may be less capable technical accountants than the man who is by-passed, and he is therefore faced with the choice of accepting the fact that his limited administrative ability will prevent him from achieving the top financial job, or of resigning from his company. In such cases a qualified accountant may be better suited to work in a smaller company where most administrative functions rest with the president or manager. Nevertheless, it is usually true that the stakes are larger in the bigger companies.

Road to Success

I can offer no short road to success in the controllership field. I think it is generally true to say that progressive companies are looking for good accountants and good administrators, and such companies will give quick recognition to the abilities shown by any employee. The nature of industrial accounting requirements is such that a qualified accountant must have a sound working knowledge of all phases of a company's organization and this knowledge causes him to be peculiarly well fitted for a general administrative position. If an accountant wants to enter the controllership field, let him not be afraid or ashamed to start at the bottom doing routine clerical work. Believe me, his seat on top of the heap will be vastly more secure if he was once among the lowest form of office life. To administer, one must understand, and to understand, one must have had the actual experience. Auditing apprenticeship and college lectures do not train us for accounting responsibilities in big companies — we have yet to learn much, and necessarily from people who are in many ways less capable than ourselves.

Some Considerations

In recent years, men who are basically accountants have been obtaining an increasing number of appointments to top administrative positions in industry, and I believe this trend will continue as the controllers in industry consolidate their positions, as overall administrators, planners and reporters to top management. There is, therefore, a tremendous field for qualified accountants in industry, but anyone who feels inclined towards the non-practising field must bear in mind the following points:

1. Small companies require accountants first and administrators second;

2. Big companies require both accountants and administrators, but the administrator will always get the top financial position while the technical accountant's potentialities are to some extent limited. Nevertheless, the technical accountant in a big company may receive more remuneration than the top financial man in a small company;

3. Progress in any company is largely dependent upon the extent to which the company's management is operating efficiently and recognizes the ability of younger men. In other words, before you go into a company, make sure it is a company for which you want to work;

4. Finally, to quote Shakespeare—"This above all — to thine own self be true". Be honest when planning a career in controllership or any other field. It is not always easy to admit one's own shortcomings and, if you find yourself

stuck in a technical accounting job with younger or new men by-passing you, be frank with yourself in deciding whether management has assessed your abilities and limitations fairly. If management is right, your limitations would be just as harmful in any company, and there is little to be gained by quitting a good company in a huff because sound management has faced its responsibilities and made decisions which are personally distasteful to the individual. If you find yourself in the top administrative position, you yourself will have to make these decisions, unpleasant as they may be for you to make.

WHAT'S IN A NAME?

THE FOLLOWING paragraph is taken from the statement of the chairman to the shareholders of Wiggins Teape and Company (1919), Limited as reproduced in *The Economist* of July 9, 1949.

> With regard to the accounts, considerable changes have had to be made in the form thereof owing to the provisions of the *Companies Act,* 1948. The main variation to which I should draw your attention is the treatment of depreciation. The *Companies Act,* 1948 requires the directors to give consideration to the adequacy or otherwise of depreciation provided for in the accounts. Your Board have considered this question and have come to the conclusion that, having regard to the method of accounting which they have always adopted in writing off to revenue the cost of renewals and replacements and to the fact that the mills have been kept in an up-to-date condition, the reserves for depreciation which had been created should no longer be treated as such. They have accordingly transferred these reserves to accounts described as "Amounts set aside for obsolescence and renewals", which appear on the liabilities side of the balance sheets. They will, of course, continue to charge similar amounts against revenue as they have done in the past.

The next item of interest, due to the order of the titles, is a table given of the elements of £1 of turnover for the year 1948 for the same company,—

	£	s.	d.
1. Raw materials, purchases and stores		12	6¼
2. Wages, salaries, pensions and social services		3	7½
3. Fuel and electric power		1	0¼
4. Rent, rates and expenses			6¾
5. Carriage			4¾
		18	1½
6. Direct taxation			11½
7. Amounts set aside for obsolescence and renewals, and reserves			6
8. Net payments to debenture and stockholders			5
	£1	0	0

Clarification of Accountant's Report When Opinion Is Omitted

Bulletin No. 23 (Revised) of the American Institute of Accountants

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The committee on auditing procedure of the American Institute of Accountants in December, 1947, issued Statements on Auditing Procedure No. 23, Clarification of Accountant's Report When Opinion is Omitted, in which it proposed an amendment to Extensions of Auditing Procedure designed to improve current reporting practices. Following the issuance of Statement No. 23, it became evident that there was considerable misunderstanding in the profession as to the objectives of the proposed amendment and its application in practice. Accordingly, the proposed amendment was revised in May, 1949, to explain more fully the committee's views on the subject. The amendment, as thus revised, was submitted to the annual meeting of the American Institute of Accountants in November, 1949, and was formally adopted.

This statement is a revision of Statements on Auditing Procedure No. 23, incorporating the amendment as adopted by the membership. It supersedes the original Statement No. 23.

(1) The presentation of financial statements on the stationery or in a report of an independent public accountant without a definitive expression clearly indicating the representations he is making as to their fairness tends to create uncertainties in the minds of those who do not have special information regarding the preparation of the financial statements. In such cases, these third parties have no basis for determining what inferences are warranted by the association of the accountant's name with the financial statements and may place undue reliance upon them.

(2) Illustrative of the practices which frequently give rise to such uncertainties are the following:

(a) The presentation of financial statements on the stationery of the accountant without comment, opinion, or signature; or with the assertion that the statements are "for management purposes only".

(b) The omission of an expression of opinion or of a specific disclaimer of an opinion in a report of an accountant in which financial statements and comments on the scope of the audit are included.

(3) In the first case it is not clear whether, by his silence, the accountant intends to express unequivocal satisfaction with the financial statements or whether he intends to disclaim any opinion at all. The assertion that the statements are "for management purposes only" leaves the reader in doubt as to whether it indicates a limitation on the scope of the audit examination, whether it merely designates the form in which fully-approved statements are presented, or whether it has some other significance. In the second case, there is a review of the accountant's procedures, but it is not clear whether those procedures were sufficient to permit the expression of an opinion.

(4) Since the accountant cannot effectively control the use to which financial statements accompanied by his name may be put, the adoption of practices which will minimize the possibility of uncertainties and misrepresentations by third parties is obviously to the interest of all concerned and should aid in the avoidance of embarrassment and damage to the profession. The committee on auditing procedure, therefore, recommends that, whenever financial statements appear on the stationery or in a report of an independent certified public accountant, there should be a clear-cut indication of the character of the examination, if any, made by the accountant in relation to the statements, and either an expression of opinion regarding the statements, taken as a whole, or an assertion to the effect that such an opinion cannot be expressed. When the accountant is unable to express an over-all opinion, the reasons therefor should be stated. When the accountant considers it appropriate to comment further regarding compliance of the statements with generally accepted accounting principles in respects other than those which require the denial of an over-all opinion, he should be careful to indicate clearly the limitations of such comments.

(5) On September 19, 1939, the membership of the American Institute of Accountants approved a report of this committee entitled *Extensions of Auditing Procedure* which stated, in part:

> The independent certified public accountant should not express the opinion that financial statements present fairly the position of the company and the results of its operations, in conformity with generally accepted accounting principles, when his exceptions are such as to negative the opinion, or when the examination has been less in scope than he considers necessary. In such circumstances, the independent certified public accountant should limit his report to a statement of his findings and, if appropriate, his reasons for omitting an expression of opinion.

(6) The views now being enunciated by the committee entail the modification and extension of this position. It is, therefore, recommended that the above-quoted paragraph, which appears on page 5 of Statements on Auditing Procedure No. 1, *Extensions of Auditing Procedure,* be amended to read as follows:

> The independent certified public accountant should not express the opinion that financial statements present fairly the position of the company and the results of its operations, in conformity with generally accepted accounting principles, when his exceptions are such as to negative the opinion, or when the examination has been less in scope than he considers necessary to express an opinion on the statements taken as a whole. In such circumstances, the independent certified public accountant should state that he is not in a position to express an opinion on the financial statements taken as a whole and should indicate clearly his reasons therefor. To the extent the scope of his examination and the findings thereof justify, he may also comment further as to compliance of the statements with generally accepted accounting principles in respects other than those which require the denial of an opinion on the over-all fairness of the financial statements. The purpose of these assertions by the accountant is to indicate clearly the degree of responsibility he is taking.
>
> Whenever the accountant permits his name to be associated with financial statements, he should determine whether, in the particular circumstances, it is proper for him to (1) express an unqualified opinion, or (2) express a qualified opinion, or (3) disclaim an opinion on the statements taken as a whole. Thus, when an unqualified opinion cannot be expressed, the accountant must weigh the qualifications or exceptions to determine their significance. If they are not such as to negative the opinion, a properly qualified opinion would be satisfactory; if they are such as to negative an opinion on the

statements taken as a whole he should clearly disclaim such an opinion. His conclusions in this respect should be stated in writing either in an informal manner, as in a letter of transmittal bound with the financial statements, or in the more conventional short-form or long-form report. However, when financial statements prepared without audit are presented on the accountant's stationery without comment by the accountant, a warning, such as *Prepared from the Books Without Audit,* appearing prominently on each page of the financial statements is considered sufficient.

It is not contemplated that the disclaimer of an opinion should assume a standardized form. Any expression which clearly states that an opinion has been withheld and gives the reasons why would be suitable for this purpose. However, it is not considered sufficient to state merely that certain auditing procedures were omitted, or that certain departures from generally accepted accounting principles were noted, without explaining their effect upon the accountant's opinion regarding the statements taken as a whole. It is incumbent upon the accountant, not upon the reader of his report, to evaluate these matters as they affect the significance of his examination and the fairness of the financial statements.

(7) It should be remembered that *Extensions of Auditing Procedure* for 10 years has precluded the expression of any opinion on the financial statements taken as a whole when the accountant's exceptions or qualifications were such as to negative the opinion. That provision is continued under the amendment. The change is concerned solely with improving current reporting practices by providing that, in such cases, the accountant should henceforth clearly indicate that he is not in a position to express an opinion on the financial statements taken as a whole, and give his reasons why.

Professional Notes

ALBERTA

Messrs. Larkham Collins, C.A., and Norman Hames, C.A., announce the formation of a partnership for the practice of their profession under the firm name of Collins & Hames, Chartered Accountants, with offices at 101 Canadian Bank of Commerce Chambers, Calgary. Mr. Hames will be the resident partner.

BRITISH COLUMBIA

Mr. Richard C. Field, C.A., announces the admission to partnership of Mr. Robert J. Taylor, C.A. They will carry on the practice of their profession under the firm name of Richard C. Field and Co., Chartered Accountants, with offices at 612 View St., Victoria, B.C.

QUEBEC

Messrs. Isidore Stein, C.A., and Benjamin Wagner, C.A., announce the formation of a partnership under the firm name of Stein & Wagner, Chartered Accountants, with offices at 1653A St. Catherine St. W., Montreal.

Final Examination Results

The Institute of Chartered Accountants of Quebec announces that, according to the report received from L'Ecole des Hautes Etudes Commerciales de Montréal, the following candidates were successful in passing the final examination held before the special Jury of the School appointed under the provisions of sec. 18 of the Institute's Charter: J. -P. -L Benoit, J. -M. Bertrand, Wilfrid Blanchard, Pierre Brosseau, Roland Caron, Maurice Clavel, André Côté, Gilles Dallaire, Jacques René de Cotret, Gustave Dionne, Réal Dubord, Louis Dufresne, Georges Fortin, Robert Gagné, Roland Godin, Jean Hébert, Marcel Jean, Jean-R. Labelle, Hector Laflamme, Maurice Laforest, Gilles Lalande, Raymond Latour, Jean-Paul Lavergne, Roderick Lemieux, Louis-Philippe Maheux, Paul-E. Mallette, Henri Masson,

Guy Messier, Gilles Moreau, Réal Moreau, P.-E. Noel, Gilles Paquette, Gilles Papin, Emilien Pelchat, L.-P. Picard, Georges Prénovost, Bernard Proulx, R.-M. Rondeau, Martin Rossignol, J.-P. Rouleau, J.-G. Rosseau, André St-Arnaud, J.-J. St-Pierre, C.-E. Tremblay.

* * *

Quebec Students' Society

On December 15, 1949, the Chartered Accountants Students' Society of Quebec held a dinner meeting at the Queen's Hotel and heard an address by Mr. L. N. Buzzell, C.A., on "sick companies". Approximately 125 members attended this affair.

The annual dance of The Chartered Accountants Students' Society of Quebec was held in the Ritz Carlton Hotel in Montreal on November 10. Among those present were the following officers of the Quebec Institute: C. N. Knowles, president; Jean Valiquette, first vice-president; G. P. Keeping, second vice-president and J. A. DeLalanne, honorary secretary-treasurer.

The second dinner meeting of the Chartered Accountants Students' Society of Quebec was held on November 24 in the Queen's Hotel, Montreal. The guest speaker for the occasion was Mr. Frank S. Capon, C.A., whose address was entitled "Controllership". This informative talk was enjoyed by one of the largest gatherings to attend such a meeting in several seasons.

ONTARIO

Mr. Norman F. W. Pragnell, C.A., announces the opening of an office for the practice of his profession at 120 Walton St., Port Hope, Ont.

* * *

Goldhar & Beckerman, Chartered Accountants, announce the admission to partnership of Mr. H. Soupcoff, C.A. Henceforth the practice of their profession will be conducted under the firm name of Goldhar, Beckerman & Soupcoff, Chartered Accountants, with offices at 79 East Don Roadway, Toronto.

* * *

London Chartered Accountants and Students Club

At the elections held recently by the Chartered Accountants and Students Club of London at the Y.M.C.A., F. B. Campbell, C.A., was elected president. Vice-presidents are G. A. McDougall, C.A., D. A. Macfarlane, C.A., Norman Murphy and F. L. Norwood. Miss N. M. Foulds, C.A., was elected secretary and Bruce McGill, treasurer. Immediate past president is K. W. Lemon, C.A.

PRINCE EDWARD ISLAND

Mr. T. Earle Hickey, C.A., announces the removal of his office to the Canadian Bank of Commerce Bldg., Summerside, P.E.I.

SASKATCHEWAN

Regina Chartered Accountants' Club

The Regina chartered accountants entertained Mr. H. R. Doane, C.A., president of the D.A.C.A., and Mrs. Doane at a mixed dinner and theatre party for the ladies on November 14. Mr. H. A. Hunt, C.A. presided and Mr. E. C. Gerry, C.A., president of the Saskatchewan Institute, proposed a toast to the ladies which was responded to by Mrs. C. H. Smith.

The Students' Department

J. E. Smyth, C.A., Editor

NOTES AND COMMENTS

ON OUR most recent visit to a library we came across an unpretentious little green book sitting patiently apart on the counter. It carried the title *The Labour Party in Perspective—and Twelve Years Later* by C. R. Attlee (London, 1949). As we picked it up casually, the thought occurred to us that Canadians had not had much opportunity to hear from Mr. Attlee as the Prime Minister of Britain. We reflected that most of Britain's worries since the end of the war had been in the field of foreign policy and economics with the result that persons like Ernest Bevin and Sir Stafford Cripps have probably been better known to us than the Prime Minister himself.

Indeed, a second glance revealed that Mr. Attlee's book had been published originally in 1937 long before the Labour Party achieved its surprising success at the polls in 1945. What we had in our hands was merely a reissue with "a new long introductory chapter by Francis Williams showing how the policy outlined in 1937 is being faithfully put into practice". The current U.K. election provided the necessary stimulus for a little research on a subject which we know very little about, and we were soon reading Mr. Attlee's opinion that "the Labour Party has had some unfortunate experiences of people whose histrionic abilities were out of all proportion to their other qualities and it cannot be blamed for caution".

Whatever his politics, a reader ought to find this book rewarding. Personally, we found it a fascinating study of the problem of moulding a political party from eager groups of special interests such as the trade unions, the cooperative movement, the academic socialists, the pacifists, and so forth. The internal politics of such a party must necessarily place a considerable premium on compromise in reaching a party platform, and the result apparently becomes rather more moderate than the policies of the component groups. In reading the book we recalled that in politics as in business the most important (and probably the least spectacular) aspect of leadership lies in the field of coordination. Possibly something of the tenor of the Labour Party's platform under Mr. Attlee's leadership may be gleaned from the following quotation:

"It is of course true that there is a vital conflict in the community between the classes that live by mere ownership and those that live by labour, but it is not nearly so clear-cut and distinct as is sometimes imagined. There are not just two sharply contrasted classes, capitalists and wage-earners. Between the man who owns nothing but his labour and the man who depends entirely on unearned income there are many grades of people, some of whom are predominantly workers while others are predominantly capitalists. In this country there are many workers who own some property; there are many capitalists who do useful service to the community."

CORRESPONDENCE

Edmonton, Alta.

Sir: I would like to express criticism of the solution appearing in the November 1949 issue of *The Canadian Chartered Accountant* for Problem 5, being *Accounting IV, Question* 4, appearing on the final examination of November, 1948.

Firstly, during February a mark-up of 25c a pair was taken on 24 dozen pairs, a total of \$72.00. At the end of April six dozen pairs of this item remained on hand, and were reduced 45c a pair. In the solution the entire 45c was apparently treated as a mark-down, whereas 25c of this was a mark-up cancellation, and the balance of 20c a mark-down. Thus the adjustment for additional mark-up should read:

additional mark-up style #60	\$72.00
less mark-up cancellation	18.00
	\$54.00

and correspondingly the mark-down should read:

mark-down recorded	\$5,900.00
less mark-up cancellation incorrectly treated as a mark-down	18.00
	\$5,882.00

This point may not be of much importance in this particular question because of the small amounts involved, but it would have quite a bearing in practice. You will readily appreciate that any change in mark-up (which is the case here) will have an effect on the complement (cost percentage), which is applied to the closing inventory at retail in order to arrive at the closing inventory at cost.

Secondly, in my opinion cost of goods sold might better be arrived at by subtracting the closing inventory at cost from the merchandise handled (opening inventory plus purchases) at cost, rather than by applying the complement of the mark-on percentage to the total of sales plus mark-downs.

Thirdly, turnover, when computed on the average monthly inventories at retail, is generally expressed in terms of net sales, not sales plus mark-downs.

C. MACGILLIVRAY

SOLUTION TO LAST MONTH'S PUZZLE

Let $S = \text{Speed}$

Then $S - 4 = $ Speed of overtaking, outwards.

Then $S + 4 = $ Speed of overtaking, returning.

Since he overtakes 4 m. each way, the time required (1 hr. of course) is

$$\frac{4}{S-4} + \frac{4}{S+4} \text{ which } = 1$$

Clearing fractions—

$4(S+4)+4(S-4) = (S-4)(S+4)$

$4S+16+4S-16 = S^2-16$

$8S = S^2-16$

$S^2-8S = 16$

Add 16 to each side and

$S^2-8S+16 = 32$

$(S-4)^2 = 32$

$S-4 = \sqrt{32}$

$S = 4+\sqrt{32}$

$= 4+5.65$

$= 9.65$ m. per hr.

Proof

Overtakes army at 5.65 m. per hr. outwards

Overtakes army at 13.65 m. per hr. returning

Time taken (minutes)

$$\frac{4}{5.65} \times 60 = 42.5 \text{ Min.}$$

and

$$\frac{4}{13.65} \times 60 = 17.5 \text{ Min.}$$

$$60 \text{ Min.}$$

PUZZLE

Eighteen years ago the Wellers got married. At the time Mr. Weller was three times as old as his wife. Now he is only twice as old as she is. How old was Mrs. Weller when she got married? (From: *Have Fun With Figures* by Joseph Degrazia, author of "Maths is Fun")

PROBLEMS AND SOLUTIONS

Solutions presented in this section are prepared by qualified accountants and reflect of course the personal views and opinions of the various contributors. They are designed not as models for submission to the examiner but rather as such discussion and explanation of the problem as will make its study of benefit to the student. Discussion of solutions presented is cordially invited.

PROBLEM 1

Intermediate Examination, October 1949

Accounting I, Question 1 (15 marks)

The following is the trial balance of the Warhoop Pipe Co. Ltd., as at 1 Jul 1948:

Cash	$ 4,000	
Accounts Receivable	16,700	
Raw Materials Inventory	57,000	
Goods in Process Inventory	9,450	
Finished Goods Inventory	157,550	
Unexpired Insurance	1,700	
Land	43,000	
Buildings	96,000	
Reserve for Depreciation—Buildings		16,000
Machinery and Equipment	84,000	
Reserve for Depreciation—Machinery and Equipment		24,000
5% Bonds payable		280,000
Accounts Payable		21,400
5% Cumulative Preferred Shares		100,000
Common Shares		81,000
Deficit	53,000	
	$ 522,400	$ 522,400

The operations for the year ended 30 Jun 1949, may be summarized as follows:

Net Sales	$ 610,000
Increase of raw materials inventory	66,000
Purchases of raw materials	350,000
Labour	62,000
Manufacturing expenses	37,100
Increase in goods in process inventory	22,000
Decrease in finished goods inventory	35,000
Selling expenses	37,000
Administrative expenses (incl. insurance)	26,700
Collected from customers	522,300
Paid to trade creditors	348,200
Unexpired Insurance at June 30, 1949	1,900
Investment in Savings Bonds in June 1949	6,000

Sales and purchases of raw materials were on credit; all other expenses were paid as incurred.

The buildings were acquired 1 Jul 1940, and have an estimated service life of 48 years.

The machinery and equipment were acquired 1 Jul 1940, and have an estimated service life of 28 years.

Required:

Worksheet arranged to segregate manufacturing costs, profit and loss items and balance sheet items as at 30 Jun 1949.

A SOLUTION

WARHOOP PIPE CO LTD.

WORKSHEET (for the year ended 30 Jun 1949)

	Trial Balance 1 Jul 1948		Transactions and Journal Entries 30 Jun 1949		Manufacturing Costs		Profit and Loss and Trading		Balance Sheet	
					Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	$ 4,000		$ 522,300(5)	$ 348,200(6) 168,800(4)					$ 9,300	
Accounts Receivable	16,700		610,000(1)	522,300(5)					104,400	
Raw Materials	57,000		66,000(2)						123,000	
Goods in Process	9,450		22,000(7)						31,450	
Finished Goods	157,550			35,000(8)					122,550	
Unexpired Insurance	1,700		200(a)						1,900	
Land	43,000								43,000	
Buildings	96,000								96,000	
Reserve for Depreciation—Buildings		16,000		2,000(b)						$ 18,000
Machinery and Equipment	84,000								84,000	
Res. for Dep.—Machinery & Equip.		24,000		3,000(c)						27,000
5% Bonds Payable		280,000								280,000
Accounts Payable		21,400	348,200(6)	350,000(3)						23,200
5% Cumulative Preferred		100,000								100,000
Common Stock		81,000								81,000
Deficit	53,000								53,000	
Sales (net)				610,000(1)				$610,000		
Purchase of raw materials			350,000(3)	66,000(2)	$284,000					
Labour			62,000(4)		62,000					
Manufacturing Expense			37,100(4)		37,100					
Selling Expense			37,000(4)				37,000			
Administrative Expense			26,700(4)	200(a)			26,500			
Investment in Bonds			6,000(4)						6,000	
Depreciation on Buildings			2,000(b)		2,000					
" Machinery & Equipment			3,000(c)		3,000					
Interest Expense			14,000(d)				14,000			
Interest Payable				14,000(d)						14,000
Increase in Goods in Proc. Inventory				22,000(7)		$ 22,000				
							366,100(e)			
Decrease in Fin. Goods Inventory			35,000(8)				35,000			
	$522,400	$522,400	$2,141,500	$2,141,500	$388,100	$ 22,000	$478,600	$610,000	$674,600	$543,200
						366,100(e)	131,400			131,400
					$388,100	$388,100	$610,000	$610,000	$674,600	$674,600

PROBLEM 2

Final Examination, November 1948

Accounting IV, Question 3 (25 marks)

The following are the post-closing trial balances of Co. 1, Co. 2 and Co. 3 as at 31 Mar, 1948:

DEBITS	Co. 1	Co. 2	Co. 3
Cash	$ 130,000	$ 40,000	$ 6,000
Inventories	212,000	166,000	40,000
Other current assets	220,000	148,000	44,000
Investments—Co. 2	384,000		116,000
Co. 3	160,000		
Securities at cost	40,000		28,000
Fixed assets less depreciation	1,280,000	748,000	186,000
Total	$ 2,426,000	$ 1,102,000	$ 420,000
CREDITS			
Accounts payable and accrued expenses	$ 211,000	$ 107,500	$ 48,000
6% bonds due 1 Jul 1960	200,000		
First mortgage 6% bonds	400,000	200,000	80,000
6% cumulative preferred stock, par $100	400,000		80,000
Common stock, no par		482,500	
Common stock, par $100	740,000		160,000
Surplus, 1 Apr 1947	245,000	222,000	60,000
Profits year ending 31 Mar 1948	230,000	90,000	8,000*
Total	$ 2,426,000	$ 1,102,000	$ 420,000

* Denotes red figure.

Investment in Co. 2 was made by Co. 1 as follows:

30 Sep 1946, 23,200 shares no par common	$ 320,000
15 Aug 1947, 4,200 shares no par common	64,000
	$ 384,000

Investment in Co. 3 was made by Co. 1 as follows:

1 Apr 1940, 400 shares preferred	$ 34,000
1 Apr 1941, 1,520 shares common	126,000
	$ 160,000

Investment in Co. 2 was made by Co. 3 as follows:

1 Apr 1943, 5,250 shares common	$ 50,375
†31 Mar 1946, 5,250 shares common (par value of stock dividend)	65,625
	$ 116,000

†On 31 Mar 1946, Co. 2 declared a stock dividend, transferring from earned surplus to capital stock the amount of $262,500, and issuing one share of common stock for each share outstanding as at that date.

The net worth of Co. 2 at the dates on which Cos. 1 and 3 purchased stock was:

	1 Apr 1943	30 Sep 1946	15 Aug 1947
Shares outstanding	21,000	42,000	42,000
Capital stock account	$220,000	$482,500	$482,500
Surplus	16,600	276,000	294,000
	$236,600	$758,500	$776,500

The net worth of Co. 3 at the dates on which Co. 1 purchased stock was:

	1 Apr 1940	1 Apr 1941
Preferred stock	$ 80,000	$ 80,000
Common stock	160,000	160,000
	$240,000	$240,000
Less Deficit	30,800	26,000
Net worth	$209,200	$214,000

Co. 1 has taken up as income only the dividends received from the subsidiaries.

Preferred dividends of Co. 3 were in arrears from 1 Apr 1939 until 31 Mar 1944, when they were paid in full. All other preferred dividends were paid at the end of each fiscal year.

At 31 Mar 1948 the inventories of Co. 1 included the following:

Purchased from	*Inventory value*	*Gross profit on sales thereof to Co. 1*
Co. 2	$40,000	$24,000
Co. 3	$28,000	$10,200

which are to be eliminated in total.

On 6 Oct 1947 Co. 1 sold marketable securities (shown at cost of $25,200 on the books of Co. 1) to Co. 2 for $30,000, the market value at this date. On 12 Mar 1948 Co. 2 sold these securities at the market value of $27,500 to Co. 3. These profits and losses are to be eliminated in total.

Inter company accounts included in other current assets and accounts payable at 31 Mar 1948 were:

Owing to	*Owing by*	*Amount*
Co. 2	Co. 1	$60,000
Co. 3	Co. 1	5,000
Co. 2	Co. 3	6,000

Required:

Consolidated work sheet of Co. 1 and its subsidiaries as at 31 Mar 1948, showing details of all eliminations and adjustments made.

A SOLUTION

Schedule of Eliminations

1. Elimination of Co. 1 investment in Co. 3

1 Apr. 1940			
Co. 3			
400 shares preferred purchased by Co. 1		$ 34,000	
Purchase price			
Worth — Capital — $\frac{400}{800}$ x 80,000	$ 40,000		
Dividend arrears			
6% — 1 year on $40,000	$ 2,400	$ 42,400	
Excess — Negative goodwill			$ 8,400
1 Apr 1941			
Co. 3			
1520 shares common purchased by Co. 1			
Purchase price		$126,000	

Worth — Capital $\frac{1,520}{1,600}$ x 160,000	$152,000		
Deficit 26,000			
Plus dividend arrears 9,600			
35,600			
$\frac{1,520}{1,600}$ x 35,600	$ 33,820	$118,180	
Deficiency — Goodwill			$ 7,820
Negative goodwill			$ 580

2. Elimination of Co. 1 & 3 investment in Co. 2

Co. 3 purchase of shares of Co. 2

1 Apr 1943

5,250 shares Common purchased by Co. 3			
Purchase Price		$ 50,375	
Worth:			
Capital $\frac{5,250}{21,000}$ x $220,000	$ 55,000		
Surplus — 16,600 x $\frac{5,250}{21,000}$	$ 4,150	$ 59,150	
Excess — negative goodwill			$ 8,775

31 Mar 1946

5,250 shares common stock dividend declared by Co. 2		
Investment price		$ 65,625
Capital — Par Value		$ 65,625
		—

Elimination combined Co. 1 & 3 re purchase by Co. 3 of shares of Co. 2:

(Co. 1 owns 95% $\frac{(1520)}{(1600)}$ of the common shares of Co. 3)

Purchase price, Co. 2 shares through Co. 3:			
95% of $116,000		$110,200	
Worth acquired in Co. 2 through Co. 3:			
Capital — 95% of ($55,000 + $65,625)	$114,594		
Surplus — 95% ($4,150)	3,942		
		118,536	
Excess — negative goodwill			$ 8,336

3. Elimination Co. 1's Investment in Co. 2

Co. 1 — purchase of shares of Co. 2

30 Sep 1946

23,200 shares common — purchased by Co. 1		
Purchase Price		$320,000

Worth—			
Capital — $\frac{23,200}{42,000} \times \$482,500$	$266,524		
Surplus — $\frac{23,200}{42,000} \times \$276,000$	$152,457	$418,981	
Excess — negative goodwill			$ 98,981

15 Aug 1947

4,200 shares common purchased by Co. 1			
Purchase Price		$ 64,000	
Worth—			
Capital — $\frac{4,200}{42,000} \times \$482,500$	$ 48,250		
Surplus — $\frac{4,200}{42,000} \times \$294,000$	$ 29,400	$ 77,650	
Excess — negative goodwill			$ 13,650
			$112,631

4. Elimination re inter-company profit in inventory

Gross profit — Co. 2	$ 24,000	
Gross profit — Co. 3	$ 10,200	$ 34,200

5. Elimination re inter-company profit on sale of securities

Co. 1 — profit on sale	$ 4,800	
Co. 2 — loss on sale	$ 2,500	
Net profit		$ 2,300

6. Adjustment re inter-company accounts receivable and accounts payable

Co. 1 Payable	$ 65,000	
Co. 3 Payable	$ 6,000	$ 71,000
Co. 2 Receivable	$ 66,000	
Co. 3 Receivable	$ 5,000	$ 71,000

7. Elimination of Minority Interest in Co. 2

Capital					
Total shares issued		42,000		$482,500	
Shares held by Co. 1	27,400		$314,774		
Shares held by Co. 3	10,500	37,900	$120,625	$435,399	
Minority Interest		4,100		47,101	$ 47,101
Surplus					
Balance — 1 Apr 1947				$222,000	
Minority Interest — $\frac{4,100}{42,000} \times \$222,000$					$ 21,671
Profit					
For year ending 31 Mar 1947				$ 90,000	
Minority Interest — $\frac{4,100}{42,000} \times \$90,000$					$ 8,786
					$ 77,558

8. Elimination of Minority Interest resulting from Co. 3 investment in Co. 2

Co. 3 holds 1/4 shares of Co. 2

Co. 1 holds $\frac{19}{20}$ of shares of Co. 3

Capital — Common issued	$482,500		
Minority interest 1/20 of 1/4 of $482,500		$ 6,031	
Surplus — Balance 1 Apr 1947	$222,000		
Minority interest— 1/20 of 1/4 of $222,000		$ 2,775	
Profit — for year ending 31 Mar 1948	$ 90,000		
Minority interest— 1/20 of 1/4 of $90,000		$ 1,125	
			$ 9,931

9. Elimination of Minority Interest in Co. 3

Capital			
Preferred—	$ 80,000		
Minority interest — 50%		$ 40,000	
Common shares	$160,000		
Minority interest — $\frac{8,000}{160,000}$ = 1/20		$ 8,000	
Surplus — Balance 1 Apr 1947	$ 60,000		
Minority interest — 1/20 thereof		$ 3,000	
Deficit for year ending 31 Mar 1948	$ 8,000*		
Minority interest — 1/20		$ 400*	
Investment in Co. 2	$116,000		
Minority interest — 1/20		$ 5,800*	
* — figure is in red.			$ 44,800

(For consolidated worksheet of Cos. 1, 2 & 3 see page 97)

PROBLEM 3

Final Examination, November 1948

Auditing 1, Question 2 (5 marks)

Why is it regarded objectionable for a chartered accountant to:

(a) advertise for business, except by professional announcements or cards?

(b) solicit business held by another chartered accountant?

A SOLUTION

The code of ethics of the various provincial institutes prohibits its members from advertising, or from soliciting business held by other members. These rules seek to protect the members as a whole from selfish impulses of any individual members.

a) The rule against advertising is in force because:

a) Advertising does not pay — a client as a rule prefers to engage an accountant who is known personally to him because of the peculiarly confidential nature of an accountant's work.

b) Professional accounting is not a commodity, but depends on the knowledge, skill,

CONSOLIDATED WORK SHEET OF COS. 1, 2 & 3
as at 31 March 1948

	Trial Balance 31 Mar 1948			Elimination & Adjustments		Minority Interest Adjustments		Balance Sheet	
	Co. 1	*Co. 2*	*Co. 3*	*Debit*	*Credit*	*Debit*	*Credit*	*Asset*	*Liability*
ASSETS									
Cash	$ 130,000	$ 40,000	$ 6,000					$ 176,000	
Inventories	212,000	166,000	40,000		(4) 34,200			383,800	
Other current assets	220,000	148,000	44,000		(6) 71,000			341,000	
Investment — Co. 2			116,000		(2) 110,200		(9) 5,800	—	
Co. 2	384,000				(3) 384,000			—	
Co. 3	160,000				(1) 160,000			—	
Securities at cost	40,000		28,000		(5) 2,300			65,700	
Fixed assets less depreciation	1,280,000	748,000	186,000					2,214,000	
	$2,426,000	$1,102,000	$420,000						
LIABILITIES									
Accounts Payable & Accruals	$ 211,000	$ 107,500	$ 48,000	(6) 71,000					295,500
6%bonds due 1 Jul 1960	200,000								200,000
1st Mortgage bonds 6%	400,000	200,000	$ 80,000						680,000
Minority Interest							(7) 77,558		
							(8) 9,931		132,289
							(9) 44,800		
6% Cumulative Preferred	400,000								400,000
stock- — Par Value $100			80,000	(1) 40,000		(9) 40,000			
Common Stock — N.P.V.		482,500		(2) 114,594		(7) 47,101			
				(3) 314,774		(8) 6,031			
Common Stock — Par $100	740,000								740,000
Common Stock — Par $100			160,000	(3) 152,000		(9) 8,000			
Surplus	245,000								
		222,000		(2) 3,942		(7) 21,671			
				(3) 181,857		(8) 2,775			345,175
			60,000	(1) 2,400	(1) 33,820	(9) 3,000			
Profit	230,000			(5) 4,800					
		90,000		(4) 24,000	(5) 2,500	(8) 1,125			
				(4) 10,200		(7) 8,786			265,989
			8,000*				(9) 400		
	$2,426,000	$1,102,000	$420,000						
Capital Reserve					(1) 580				
					(2) 8,336				
					(3) 112,631				121,547
								$3,180,500	$3,180,500

* — figure is in red.

experience and integrity of the accountant — therefore, if he advertises himself as being smart, skilful, etc., the client is less likely to have confidence in him.

c) Advertising has a commercial flavour, unbecoming to a professional man.

d) Advertising would not benefit the small practitioner (usually the young accountant establishing himself in practice) because the older, well-established firms could afford to advertise on such a scale that the smaller firms would be completely over-shadowed.

b) The rule against solicitation is in force because:

a) By the very act of solicitation, the accountant places himself in an inferior position to the client, and thus robs himself of his independence.

b) This rule helps to preserve harmony within the profession.

c) Solicitation would tend to lower professional standards.

PROBLEM 4

Final Examination, November 1948

Auditing 1, Question 6 (10 marks)

Explain the difference between the LIFO and base stock methods of inventory valuation. State the advantages and disadvantages of each.

A SOLUTION

LIFO means literally "last-in first-out" and indicates that the cost of goods sold is arrived at by using the most recent costs. In other words goods sold are deemed for cost purposes to be those last received. Inventories are valued on the basis of cost, either at date of adoption of LIFO or at the date of accumulation, if the accumulation takes place after the adoption of LIFO.

Base stock assumes a portion of the inventory is always required to be on hand and in process, and this portion is priced at its original cost, or at a cost lower than the original cost. The value of this portion of the inventory therefore remains constant, but the goods on hand in excess of basic stock requirements are valued according to some other method such as LIFO, FIFO, or average cost.

The LIFO and base stock methods of inventory valuation may produce the same result in certain circumstances. Perhaps the main differences between the two methods are in the treatment of the following items:

1. Accumulations in excess of original quantities under the LIFO method are valued on the LIFO principle, whereas under the base stock method they may be valued on various bases such as FIFO, LIFO or average cost.
2. After original quantities have been decreased, replacements under the LIFO method would be valued at cost at time of replacement, but under the base stock method they would be valued at the original base stock price.

In Canada, neither method has been accepted for income tax purposes.

The LIFO method results, as stated above, in matching the most recent costs against revenues, and tends to level off the fluctuation in cost of goods sold between periods of rising and falling prices. One of the difficulties with LIFO is that the size, shape, and inherent quality and structure of the items in the inventory may change considerably over the years. For instance, a merchant may have had an inventory of 1,000 radios, valued at LIFO, as at 31 December 1927; while his inventory may include 1,000 radios as at 31 December 1947, these machines bear little relationship to those on hand 20 years before.

The base stock method is generally thought of as applicable in certain processing industries, such as ore smelting, where a minimum of the material must always be in process, and therefore is of a similar nature to a fixed asset. It has the advantage of excluding from the profit computation the effect of price fluctuations in the more or less constant quantity of material in process and on hand.